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Note: This is the last pamphlet in Volume 95.

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–AM B/C Stations
BC Docket No. 82–538

AM Station, Technical Standards
Section 73.52 of rules amended regarding relative phase tolerances for directional AM Stations. Section 73.68 amended to expand use of toroidal transformers and to provide for use of radio frequency relays in sampling element transmission lines. Outmoded rules and procedures revised or eliminated.
–Amended of Part 73
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Application for Review
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–Absolutely Great Radio, Inc.
BC Docket No. 80–366

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–Tully-Warwick Corp.
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Authority Delegation of, by FCC
Authority delegated to General Counsel in hearing proceedings to dismiss: (1) unauthorized interlocutory appeals, and (2) requests for substantive relief which Commission may not grant because jurisdiction over proceeding has terminated.
–Amendment of Part O

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–Pacific Telecommunications
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–Amendment of Part 73
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CATV
Direction letter adopted admonishing licensee for not fully implementing its EEO program. Licensee is required to submit and updated EEO program and periodic employment reports.
–Perry Cable TV Corp.

CATV Carriage, Mandatory Signal
Requests for reinstatement and review of petitions for waiver of the mandatory signal carriage rules, which has been, respectively, dismissed and denied pursuant to delegated authority denied. Denial of applications furthers Commission objective of providing efficient and expeditious service to the public.
–Com-West, Inc.

CATV Carriage, Satellite Stations
Petition for expedited Special Relief and Declaratory Ruling filed under Section 76.7 of Commission's Rules granted to an extent. Commission emphatically states its authority to preempt state and local regulation of SMATV systems that interfere with delay, or terminate interstate and federally controlled communications services.
–Earth Satellite Communications, Inc.

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Request for issuance of a declaratory ruling granted. Commission has preempted state and local rate regulation of tiered services offered to cable subscribers.
–Community Cable TV, Inc.

(See also: CATV Carriage, Satellite Stations–*Earth Satellite Communications, Inc.*)

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(See also: CATV Carriage, Satellite Stations–*Earth Satellite Communications, Inc.*)

CATV Registration Procedure
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–*Clearview Cable TV, Inc.*

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–*Bell Operating Companies*
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–*AT&T*
Docket No. 21499

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embedded customer premises equipment owned by the Bell System and approving the capitalization of AT&T Information Systems in connection with the transfer of equipment.
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(See also: Competition, Common Carriers–*Second Computer Inquiry*)

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(See also: CATV Carriage, Satellite Stations–Earth Satellite Communications, Inc.)

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–*CBS, Inc.*

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(See: Competition, Common Carriers–*Second Computer Inquiry*)

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–*Multi-City Identification*
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Application For Review
FM Station, Authorization
Ownership, Minority, Comparative Preference
Review By Commission

Applications for review of Review Board's Decision, 92 FCC 2d 1171, granted in part and denied in part. Decision modified favoring grant of Absolutely Great's application by awarding enhancement credits stemming from its minority and female ownership.
–Absolutely Great Radio, Inc.
BC Docket No. 80–366

FCC 83–464

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Applications of	
ABSOLUTELY GREAT RADIO, INC. Ventura, California	BC Docket No. 80–366 File No. BPH-11145
VENTURA BROADCASTING CO. Ventura, California	BC Docket No. 80–367 File BPH-781129AH
WILLIAM SHEARER AND ARIKE LOGAN-SHEARER, JOINT TENANTS Ventura, California	BC Docket No. 80–369 File No. BPH-790323AC
For Construction Permit for a New FM Station	

Appearances

B. Jay Baraff, Aaron Shainis and *Lee J. Peltzman* on behalf of Absolutely Great Radio, Inc.; *Martin R. Leader, Clifford M. Harrington* and *David D. Oxenford* on behalf of Ventura Broadcasting Co.; *James L. Winston, Walter E. Diercks* and *Harry P. Warner* on behalf of William Shearer and Arike Logan-Shearer, Joint Tenants; and *Charles W. Kelley* and *Joseph A. Belisle* on behalf of the Chief, Mass Media Bureau, Federal Communications Commission.

DECISION

(Adopted: October 6, 1983; Released: October 13, 1983)

BY THE COMMISSION:

1. This proceeding involves three mutually exclusive applications for a new FM station in Ventura, California, filed by Ventura Broadcasting Company (Ventura), Absolutely Great Radio, Inc. (Absolutely Great) and William Shearer and Arike Logan-Shearer, Joint Tenants (Shearer). Both Ventura and Absolutely Great propose 100% fulltime integration. Shearer is 100% owned by William Shearer, who will work fulltime at the station, and his wife, Arike Logan-Shearer, who will work parttime at the station. The Shearers are black; they do not presently reside in Ventura but propose to move to Ventura if their application is granted. Ventura and Absolutely Great are 15% and 15.5% minority owned, respectively, and offer 85% and 84.5% local residence, respectively. In addition, Absolutely Great is 49% female owned.

2. In a Decision (FCC 83R-9, 92 FCC 2d 1171), the Review Board granted the Shearer application. The Board credited all three applicants with 100% fulltime integration but found that the qualitative enhancements of the Shearers' integration proposal exceeded those of Ventura and Absolutely Great. In awarding the Shearers 100% fulltime integration credit, the Board relied on *Alexander S. Klein, Jr.* , 86 FCC 2d 423, 425–27 (1981), where the separate media interest of husband and wife were considered commonly because of the "clear community of interest" which generally exists between spouses. The Board indicated that in future cases where one spouse is fully integrated and the other is not, it will assume that the integrated owner is acting on behalf of the marital entity without requiring an evidentiary showing that the integrated spouse exercises contrl over the interest held by the less active spouse. The Board concluded that the Shearers' proposal will provide the best practicable service to the public because the Shearers' substantial enhancement credit for 100% minority ownership outweighed the credit to which Ventura and Absolutely Great are entitled for local residence and Absolutely Great's credit for its 49% female ownership, 15.5% of which is owned by a Hispanic.

3. Now before us are: (a) an application for review of the Review Board's Decision, filed March 7, 1983, by Absolutely Great Radio, Inc.; (b) an application for review, filed March 7, 1983, by Ventura Broadcasting Company; (c) an opposition to applications for review, and erratum thereto, filed March 22, 1983, by William Shearer and Arike Logan-Shearer, Joint Tenants; (d) partial opposition to application for review, filed March 22, 1983, by Absolutely Great Radio, Inc.;

(e) motion to enlarge issues and reopen the record, filed April 13, 1983, by William Shearer and Arike Logan-Shearer, Joint Tenants;[1] (f) opposition to motion to enlarge issues and reopen the record, filed April 27, 1983, by Ventura Broadcasting Company; (g) petition to enlarge issues, filed June 20, 1983, by Absolutely Great Radio, Inc.;[2] (h) opposition to petition to enlarge issues, filed July 6, 1983, by Ventura Broadcasting Company; (i) opposition to petition to enlarge issues, filed July 13, 1983, by William Shearer and Arike Logan-Shearer, Joint Tenants; (j) reply, filed July 27, 1983, by Absolutely Great Radio, Inc.; (k) motion to strike and motion for leave to file, filed July 29, 1983, by William Shearer and Arike Logan-Shearer Joint Tenants;[3] (l) petition to reopen the record and enlarge issues, filed August 18, 1983, by Absolutely Great Radio, Inc;[4] (m) opposition, filed September 7, 1983, by Ventura Broadcasting Company; and (n) reply, filed September 26, 1983, by Absolutely Great Radio, Inc.

4. We substantially agree with the findings and conclusions of the Board, and they are affirmed except as they are modified herein. We find, however, that the Board erred in awarding 100% fulltime integration credit to Shearer. In our view, the factors favoring the grant of Absolutely Great's application outweigh those favoring the grant of either Shearer's or Ventura's application and compel a finding that a grant to Absolutely Great will better serve the public interest. Thus, we will grant review, modify the Review Board's Decision, and grant Absolutely Great's application.[5]

5. William Shearer and Arike Logan-Shearer are joint tenants with each having a 50% undivided interest in the whole. Mr. Shearer plans to work fulltime at the station as its general manager and sales manager. His wife will be public affairs director; she proposes to work 20 hours per week at the station. For the reasons which

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[1] On March 31, 1983, Ventura amended its application to advise the Commission that 85% owner Michael Thomas had become general manager of Station KOVA-FM in Ojai, California and that he paid $40,000 for an option to purchase KOVA-FM. The Shearers maintain that the March 31, 1983 amendment requires the addition of Section 1.65, financial, diversification, and unauthorized transfer of control issues against Ventura. In view of our action herein, we will dismiss the motion to enlarge issues as moot.

[2] Absolutely Great seeks the addition of Section 73.3526 issues against both the Shearers and Ventura for various violations of our public file rules. In view of our action herein, we will dismiss the petition to enlarge issues as moot.

[3] The Shearers seek to strike a portion of Absolutely Great's July 27, 1983 reply on the ground that it contains scandalous material. In view of our action herein, we will dismiss the motion to strike as moot.

[4] Absolutely Great seeks the addition of an issue to determine whether Ventura misrepresented or lacked candor in its Opposition to Petition to Enlarge Issues, filed July 6, 1983. In view of our action herein, we will dismiss the Petition to Enlarge as moot.

[5] We do not believe that briefs or oral argument will significantly contribute to our understanding of the matters raised in the applications for review.

follow we conclude that the Shearers are entitled to 50% fulltime and 50% parttime integration credit for their proposal.

6. In awarding the Shearers 100% fulltime integration credit, the Board relied upon our recent decision in *Alexander S. Klein, Jr.* There we determined that it would be appropriate to treat media interests of a husband and wife in combination for diversification purposes unless the presumption of common control between a husband and wife is rebutted.[6] The basis of the decision in *Klein* to extend the presumption which had been used in applying our multiple ownership rules to diversification was the fact that our multiple ownership rules and the diversification criteria are facets of the same policy.[7] However, we have not extended the presumption of common control to integration and we decline to do so at this time.[8] Diversification and integration involve entirely different considerations. In diversification cases we seek to promote the maximum diffusion of control of the media. Our ultimate concern in such cases is the possibility of concentration of control. Thus, we evaluate media interests in terms of the *potential* impact on media concentration and diversity of viewpoint without resolving whether such concentration will *actually* occur. On the other hand, integration credit is awarded because of the inherent desirability that legal responsibility and day-to-day performance be closely associated.[9] In order to effectuate this goal, we insist that *actual* participation and legal ownership be physically commingled and and award credit only where those with legal responsibility for the applicant will personally participate in the management of the proposed station.[10] Since a spouse may participate in ownership decisions affecting the station

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[6] *Alexander S. Klein, Jr.*, 69 FCC 2d 2134, 2141 (Rev. Bd. 1978), *aff'd*, 86 FCC 2d 423, 426–27 (1981).

[7] Id. at 2141. *See Lady Sarah McKinney and J. Shelby McCallum*, 59 FCC 2d 398 (1976), where we held that for purposes of determining compliance with the multiple ownership rules, marriage creates a presumption of common control. Due to the unusual circumstances involved in that case, however, we granted the parties a waiver of the rule.

[8] There are other instances where diversification and integration have been treated differently. Management level employees with no ownership interests are not entitled to integration credit, but their interests are considered for diversification purposes. *Guy S. Erway*, 48 RR 2d 829, 831, n.6 (Rev. Bd. 1980); *Berryville Broadcasting Co.*, 70 FCC 2d 1, 13–16 (Rev. Bd. 1978); *Policy Statement on Comparative Broadcast Hearings*, 1 FCC 2d 393, 394, 395, n. 5 (1965). Limited partners and preferred stockholders get no integration credit since they do not have the right to vote their interest but their interests are considered for diversification purposes. *Compare Anax Broadcasting Inc.*, 87 FCC 2d 483 (1981); *Merrimack Valley Broadcasting Inc.*, 92 FCC 2d 506, 510, n.2 (Rev. Bd. 1982); and *Bradley, Hand, and Triplett*, 89 FCC 2d 657 (Rev. Bd. 1982) *with Cleveland Television Corp.*, 91 FCC 2d 1129, 1138–39 (Rev. Bd. 1982), *review denied* FCC 83 235, released, May 18, 1983; and *Greater Wichita Telecasting, Inc.* 90 FCC 2d 1046, 1048–49 (Rev. Bd. 1982).

[9] *Policy Statement on Comparative Broadcast Hearings*, 1 FCC 2d 393, 395 (1965).

[10] *See Ottumwa Broadcasting Co.*, 55 RR 2d 1447, 1451 (Rev. Bd. 1982), where the

without actually becoming involved in its day-to-day management, automatically attributing the interest of the less active spouse to the integrated spouse, without proof that the less active spouse will defer to the integrated spouse in all matters pertaining to the station, would not, in our view, further the goals of integration.[11]

7. In our view, Dr. Logan-Shearer's 50% interest may not be attributed to her husband for integration purposes. Since integration credit is awarded for personal participation in the management of a station, ownership interests held by a husband and wife are generally evaluated separately for integration purposes.[12] In cases where both spouses propose to work at the station, but only one spouse is entitled to integration credit for his/her role at the station, the integrated spouse is not credited with his/her spouse's interest.[13] On the other hand, spousal attribution has been permitted in integration cases where the evidence establishes that the fully integrated spouse exercises control over the interest held by the inactive spouse.[14]

Review Board refused to allow any integration credit where one spouse had an ownership interest and the other spouse, who had no ownership interest, would be participating in the management of the station.

[11] The Board rejected the requirement that deference must be shown to allow attribution because it recoiled from permitting litigation over whether one spouse is likely to be deferential to the other. Decision, para. 9. We believe, however, that requiring evidence of such deference is no more intrusive on the marital relationship or difficult as a matter of evidentiary proof than permitting competing parties to explore whether sufficient individual interests are present in a particular marital relationship to rebut the Board's presumption.

[12] *American International Development, Inc.*, 86 FCC 2d 808, 818, n.54 (1981); *Alexander S. Klein, Jr.*, 86 FCC 2d 423, 428 (1981); *Radio Laredo, Inc.*, 87 FCC 2d 353, 362 (Rev. Bd. 1981). *See also Ottumwa Broadcasting Co., supra.*

[13] *Scott & Davis Enterprises, Inc.*, 88 FCC 2d 1090, 1095 (Rev. Bd. 1982) (applicant got no credit for his wife's 10% because her fulltime sales role was not managerial); *Bradley, Hand, & Triplett*, 89 FCC 2d 657, 661 (Rev. Bd. 1982) (applicant got no credit for the wife's 20% where only an administrative position was proposed); *Muncie Broadcasting Corp.*, 89 FCC 2d 123, 132 and n.4 (Rev. Bd. 1982) *aff'd*, FCC 82–234, released May 19, 1983 (widow not entitled to integration credit for deceased husband's 50% because husband only served as a consultant to the station until his death); *Robert M. Zitter and Hillary E. Zitter*, 59 FCC 2d 274–75 (Rev. Bd. 1976) (applicant credited with only 50% integration where wife would consult and work parttime at the station).

[14] *The New Continental Broadcasting Company*, 88 FCC 2d 830 (Rev. Bd. 1981), *reconsideration denied*, 89 FCC 2d 631 (1982) (attribution allowed where wife agreed to defer to husband in all matters pertaining to the station and did not propose to work at the station); *Bie Broadcasting Co.*, 81 FCC 2d 40, *rev'd on other grounds*, 81 FCC 2d 1 (Rev. Bd. 1980) (attribution allowed where wife's interest derived solely from the husband and the stock was placed in joint tenancy for estate purposes. *But see East St. Louis Broadcasting Inc.*, 19 FCC 2d 300, 346 (Hearing Examiner 1969), affirmed, 29 FCC 2d 170, 173–174 (1971) where we simply adopted the integration percentages utilized by the Hearing Examiner without discussing the question of spousal attribution. To the extent that *East St. Louis* may be contrary to the result which we reach here, the question does not appear to have been argued before the Commission. Moreover, as we hold in this case, integration credit is not warranted unless the evidence establishes that the

8. Based upon our review of the record, we find no basis for regarding Mr. Shearer as the owner of the entire 100% interest. Both the Shearers testified that it was their intention and understanding that each would own 50% of the applicant (Tr. 992, 1073).[15] Moreover, the record contains no affirmative evidence that Dr. Logan-Shearer intends to defer to her husband in all matters concerning the operation of the station. The Shearers testified that Dr. Logan-Shearer will share decision-making responsibility with her husband for managing the station (Tr. 993, 998, 1070). Moreover, Dr. Logan-Shearer proposes to participate in a managerial capacity as parttime public affairs director for the station. Such a position will necessarily involve Dr. Logan-Shearer in decision-making at the station. Indeed, Shearer would not be entitled to any integration credit for Dr. Logan-Shearer's proposed participation unless she exercised independent judgment apart from her husband in carrying out the managerial responsibilities of her position. The facts that Dr. Logan-Shearer lacks broadcast experience (Tr. 1051) and may work under her husband's supervision (Tr. 990, 1014, 1051) do not, in our view, constitute probative evidence that Dr. Logan-Shearer will defer to her husband in all matters concerning the operation of the station. In this regard, a lack of broadcast experience is remediable and thus provides no basis for a suggestion of prolonged deference to the views of an owner with previous broadcast experience.[16] Furthermore, it is customary for the general manager to supervise other managerial employees at the station. Since it is clear that Dr. Logan-Shearer exercises full control over 50% of the applicant, the Shearers can receive no more than 50% credit for Mr. Shearer's proposal to work fulltime at the station. In addition, they are entitled to 50% parttime credit for Dr. Logan-Shearer's proposal to serve as the station's Public Affairs Director.[17]

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less active spouse will defer to the integrated spouse in all matters concerning the operation of the station and that the integrated spouse controls the entire interest held jointly with his/her spouse.

[15] The fact that the Shearers are joint tenants does not give either party control over more than 50% of the applicant under California law. It is well established that a joint tenant may alienate only his undivided share of the whole. 48A C.J.S. Joint Tenancy §35b. *Accord Wilk* v. *Vencill*, 180 P. 2d 351, 30 C.2d 104; *Santoro* v. *Carbone*, 99 Cal. Rptr. 488, 22 C.A. 2d 71; *Meyer* v. *Wall* 75 Cal. Rptr. 236, 270 C.A. 2d 24. Moreover, joint tenants are not partners, and the mere relationship of joint tenants does not authorize one joint tenant to act as an agent for the other. 48A C.J.S. Joint Tenancy §31. *Accord Stark* v. *Coker*, 129 P.2d 390, 20 C.2d 839 (1942).

[16] *Cf. Webster-Baker Broadcasting Co.*, 88 FCC 2d 944, 951–52 (Rev. Bd. 1982); and *Family Broadcasting Group*, FCC 83R-15, released March 4, 1983, 53 RR 2d 662 (Rev. Bd. 1983).

[17] Awarding Shearer 50% fulltime and 50% parttime integration credit does not, as the Board reasoned, frustrate the personal participation goal of integration by penalizing the applicant for Dr. Logan-Shearer's decision to participate in the management of the station. If Dr. Logan-Shearer had chosen not to participate in the management of the station at all, Shearer would have been entitled to only

9. Having determined that Shearer is not entitled to 100% fulltime integration credit, we find that Shearer ranks a distant third behind Absolutely Great and Ventura. In this regard, we have indicated that we are primarily interested in fulltime participation and that credit will drop sharply for less than fulltime participation.[18] It is well established that qualitative attributes of participating owners may enhance the value of a integration proposal but cannot overcome clear quantitative differences.[19] Thus, the choice is between Ventura and Absolutely Great both of whom proposed 100% fulltime integration.[20] This choice must be based upon a comparison of the qualitative attributes of their integrated owners.

10. Absolutely Great is entitled to credit for local residence and civic participation because two of its stockholders, Mr. and Mrs. Sylvester, holding 84.5% of the stock, have lived in Ventura and been active in civic affairs since 1977. Ventura can also claim credit under local residence and civic participation because its 85% stockholder Mr. Thomas has lived in the city of Ventura and has been active in civic affairs since 1974.[21] Since the difference in stock holdings is *de minimis*, since both the Sylvesters and Mr. Thomas have lived in Ventura a sufficient amount of time to become familiar with the needs and interests of the community,[22] and since both

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50% fulltime integration credit based on the record in this case. It is only because of her parttime involvement in a management level position that the applicant is entitled to any credit beyond Mr. Shearer's 50% interest.

[18] *Policy Statement on Comparative Broadcast Hearing*, 1 FCC 2d 393, 395 (1965).

[19] *Alexander S. Klein, Jr.*, 86 FCC 2d 423, 428–29 (1981); *Van Buren Community Service Broadcasters, Inc.*, 87 FCC 2d 1018, 1022 (Rev. Bd. 1981).

[20] Notwithstanding Ventura's argument to the contrary, the Review Board properly credited Absolutely Great with 100% fulltime integration. We reject the contention that Absolutely Great is not entitled to integration credit for the proposed participation as director of public and minority affairs and assistant program manager of 15.5% shareholder, Dora Luz Lara, because she is an alien. Section 310(b)(3) of the Communications Act provides, in pertinent part, that a broadcast license shall not be granted to "any corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of record or voted by aliens. . ." This provision was designed to prevent actual alien control rather than the mere possibility of alien control. *James A. Noe* v. *FCC*, 260 F.2d 739, 742 (D.C. Cir. 1958); *Data Transmission Company*, 52 FCC 2d 439, 440 (1975). Since Ms. Lara owns only 15.5% of the stock and is not a director or officer of the corporation, Absolutely Great has fully complied with the provisions of the Act. Furthermore, her proposed position at the station does not raise a question of *de facto* control. Since there has not been a showing that Ms. Lara's alien alien status will impair her ability to effectuate her integration proposal, we do not believe Section 310(b)(3) should be expanded to disallow integration credit for alien participation.

[21] Although Mr. Thomas has lived in Ventura and Ventura County for various periods between 1958 and 1974, he has lived continuously in the city only since 1974.

[22] Local residence and civic participation are significant because they indicate "a knowledge of and interest in the welfare of the Community" which will be served by the licensee. *Policy Statement on Comparative Broadcast Hearings*, 1 FCC 2d

Thomas and the Sylvesters have participated in a variety of civic activities,[23] we conclude that neither applicant is entitled to a preference for local residence and civic participation.

11. Ventura is entitled to a preference over Absolutely Great for broadcast experience because both Mr. Thomas (85%) and Mr. Dela Pena (15%) have broadcast experience whereas only Mr. and Mrs. Sylvesters (84.5%) can claim credit for broadcast experience. We do not find that the difference between the applicants in terms of broadcast experience is substantial. Moreover, Mr. Thomas' experience is primarily restricted to engineering.[24] Accordingly, we will award Ventura only a slight preference for broadcast experience.

12. Ventura's integration proposal is enhanced by 15% minority ownership. On the other hand, Absolutely Great is 15.5% minority owned and 49% female owned.[25] Moreover, a more significant managerial position is proposed for Absolutely Great's minority owner, Dora Luz Lara, than for Ventura's minority owner, Edward Dela Pena. In her capacity as director of public and minority affairs and assistant program director, Dora Luz Lara will act as a liaison with minority groups in the community, develop news from these sources, and develop specific programs to deal with the concerns of all minorities. On the other hand, Edward Dela Pena's duties as chief engineer for Ventura will include a number of nonmanagerial tasks, such as recording news actualities and station promos, because the need for his services as chief engineer will greatly diminish once the station becomes operational.[26] In view of the closeness of Ventura

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393, 396 (1965); *Lynn Mountain Broadcasting*, 9 FCC 2d 854, 855-56 (Rev. Bd. 1967).

[23] Michael Thomas had been a member of Temple Beth Torah and the Ventura Parents-Teachers Association for approximately twelve years. He has also been active in youth related activities, including the Foothill Little League and the Girl's Tri-Valley Softball League. As a management level employee of radio stations in the Ventura area, Thomas has worked with numerous organizations over the past 18 years. (VBC Ex. 2, pp. 5-6). The Sylvesters are active in the PTA, and belong to the Chamber of Commerce where Mrs. Sylvester serves on several committees (AGR Ex. 2, p. 11). They have also participated in a parents' group seeking the establishment of a Montessori school in Ventura. (AGR Ex. 3, pp. 10-11).

[24] From 1947 to 1977, Mr. Dela Pena held various positions, including Chief Engineer, with Stations KHJ and KRTA-FM in Los Angeles. Prior to 1947, Dela Pena served with Armed Forces Radio as liaison with the recording studio producing entertainment material for the Armed Forces and worked as a sound recording engineer for Standard Broadcasters. (VBC Ex. 3, p. 2; Tr. 889). In addition to extensive engineering experience, Dela Pena has negotiated labor contracts, conducted ascertainment surveys, trained technical personnel, participated in an editorial advisory board, served on a management panel which discussed matters of community interest on the air, and established music programming for an automated FM station. (VBC Ex. 3, p. 3; Tr. 889 and 890).

[25] Donna Sylvester is a 33.5% stockholder and Dora Luz Lara is a 15.5% stockholder in Absolutely Great.

[26] Our *Comparative Policy Statement on Broadcast Hearings*, 1 FCC 2d 393, 395

and Absolutely Great, we will award Absolutely Great enhancement credits for minority ownership based upon the quality of Ms. Lara's integration proposal ownership and the importance of her managerial position, and for its 49% female ownership.

13. On balance, we conclude that Absolutely Great deserves a preference for integration and that the grant of Absolutely Great's application would best serve the public interest. Under our 1965 *Policy Statement* broadcast experience has minor significance since it confers only an initial advantage.[27] Thus, Ventura's slight plus for broadcast experience is insufficient to overcome Absolutely Great's enhancement credits stemming from its minority ownership and female ownership.

14. ACCORDINGLY, IT IS ORDERED, That the Applications for Review, filed March 7, 1983, by Absolutely Great Radio, Inc. and Ventura Broadcasting Company ARE GRANTED in part and DENIED in part; that the Decision of the Review Board (FCC 83R-9, released February 4, 1983) IS MODIFIED as reflected herein; and that the application of Absolutely Great Radio, Inc. (File No. BPH-11145) for a construction permit to establish a new FM station at Ventura, California IS GRANTED, and the applications of William Shearer and Arike Logan-Shearer, Joint Tenants (File No. BPH-790323AC) and Ventura Broadcasting Company (File No. BPH-781129AH) ARE DENIED.

15. IT IS FURTHER ORDERED, That the Motion to Enlarge Issues and Reopen the Record, filed April 13, 1983, by William Shearer and Arike Logan-Shearer, Joint Tenants, the Petition to Enlarge Issues, filed June 20, 1983, by Absolutely Great Radio, Inc., the Petition to Reopen the Record and Enlarge Issues, filed August 18, 1983, by Absolutely Great Radio, Inc., and the Motion to Strike and the Motion for Leave to File, filed July 29, 1983, by William Shearer and Arike Logan-Shearer ARE DISMISSED as moot.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

(1965) indicates that we will accord particular weight to certain policy making positions, such as program director and director of public service programming, and that other positions entail less responsibility (such as chief engineer) will be given less decisional significance. *See also East St. Louis Broadcasting Co.*, 29 FCC 2d 170, 172 (1971), citing *Grand Broadcasting Co.*, 36 FCC 925, 929-30 (1964), where we ranked chief engineer as being less significant than either program director or director of public service broadcasting. Since *Grand* and the 1965 *Policy Statement* predate our more recent commitment to minority involvement in broadcasting, neither mentions director of minority affairs. We believe, however, that this position is analogous to director of news, sports or public service broadcasting, which has consistently been ranked above chief engineer in importance.

[27] 1 FCC 2s 393, 396.

AM Station, Operating Hours
Daytime Station
Operation, Hours of
Presunrise Service Authority
Sunrise
Sunset

Section 73.99 of Commission's rules amended (1) to allow additional pre-sunrise use of U.S. Class I-A Clear Channels, (2) to permit post-sunset operation by Class II-D and Class III daytime-only stations, and (3) to permit the use of diurnal curves for interference calculations relating to pre-sunrise and post-sunset operations.
–AM B/C Stations
BC Docket No. 82–538

FCC 83–412

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
Hours of Operation of Daytime-Only AM Broadcast Stations	BC Docket No. 82–538 RM-3983

FIRST REPORT AND ORDER

(Adopted: September 9, 1983 Released: September 20, 1983)

BY THE COMMISSION:

INTRODUCTION

1. The Commission has before it the *Notice of Proposed Rule Making and Notice of Inquiry* in this proceeding adopted August 4, 1982.[1] This proceeding was begun in response to petitions for rule making filed by the National Telecommunications and Information Administration ("NTIA") and the National Radio Broadcasters Association ("NRBA"). The focus of the NTIA petition was on the limitations placed on the hours of operation of daytime-only stations.[2] As the NTIA petition pointed out, these stations are licensed

[1] This *Report and Order*, addresses the issues raised in the rule making section of the document. Consideration will be given to the issues raised in the inquiry section of the document at a latter date.

[2] The NRBA petition did not deal with this subject but with the criteria used by the

to operate only during daytime hours, that is, from local sunrise to local sunset. Although in certain instances they may be able to operate with reduced power during pre-sunrise hours, NTIA noted that beginning at 6:00 a. m. local time, a significant number of daytime-only stations are unable to obtain the benefits of pre-sunrise operation. Moreover, none of these daytime-only stations has the authority to operate after local sunset.[3] NTIA believed that the current rules regarding the hours of operation of daytime-only stations impose excessive limitations, and it argued that these limitations can be and should be eased. This position was supported in many of the filings made in response to the NTIA petition. A number of these parties called for a review of this subject so that the Commission could take into account the important changes that have taken place in AM listening patterns. The Commission agreed that the subject warranted exploring, and this proceeding was begun with the goal of relieving current restrictions to the maximum extent possible consistent with sound engineering practice.[4]

Background

2. Before discussing these proposals, it is desirable to provide some background material regarding AM signal propagation in order to place this subject in better perspective. Signals with different frequencies (or wavelengths) in the AM broadcast band[5] have unique characteristics, the most important of which for the present purposes is that they produce different effects during daytime and nighttime hours. During all periods of the day, AM broadcast stations transmit signals that travel in two basic directions. Those signals which travel parallel to the surface of the Earth are referred to as "groundwaves". Those which travel upward, away

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Commission in determining the acceptability for filing of applications for AM nighttime operation. NRBA urged the Commission to amend Section 73.37(e) of the rules so that daytime-only stations could obtain nighttime operation without having to meet allocations acceptance criteria. This proposal was included in the *Notice of Inquiry* section of the document.

[3] The subject daytime-only stations are not the only ones affected by these limitations. There also are full-time stations which have different modes of operation during daytime and nighttime hours. Pre-sunrise authority is available to some of these full-time stations, thus enabling them to begin operation with daytime or critical hours antenna systems at 6:00 a.m. local time.

[4] International agreements also place limitations on the hours of operation of daytime-only stations. As discussed later, these agreements must be taken into account in formulating any new rules governing pre-sunrise or post-sunset operation by these stations. The principal agreements are: (1) the 1950 North American Regional Broadcasting Agreement ("NARBA"); (2) the 1967 Exchange of Notes between the United States and Canada; (3) the 1968 United States-Mexican Agreement; and (4) the 1947 Pre-Sunrise Agreement with the Bahama Islands.

[5] Although there are differences in the signal propagation characteristics of the 107 channels in the AM broadcast band (535–1605 kHz), they share in common a capacity to produce high skywave fields at nighttime.

from the station are referred to as "skywaves". Although groundwave signal values vary depending on frequency and ground conductivity, they do not change from day to night. Because of this continuity and the absence of "fading", groundwave signals are relied on to provide "primary" service. Skywave signals behave quite differently. During the day, most of the skywave signals are not reflected back to the earth and have no significant effect on the Earth.[6] At night, however, the ionosphere acts like a mirror, reflecting these signals back to earth, hundreds or even thousands of miles away, where they have the potential for causing serious interference to the signals of other stations. By way of contrast, at these great distances, groundwave signal values would be too low to cause interference problems. Because of the greater skywave potential for interference at night, AM allocations decisions must take into account the difference between daytime and nighttime signal propagation. The change from one propagation condition to the other is a gradual one. The transition from daytime to nighttime conditions can be said to begin two hours before sunset and to continue until two hours after sunset. A similar transition from nighttime to daytime conditions takes place during the period from two hours before sunrise until two hours after sunrise.[7] Although these two transitional periods are equivalent, the changes do not occur at the same rate in the two periods. Reliable diurnal curves are the only way to take these matters into proper account. There is one final complication which the Commission has to take into account in making its allocations and licensing decisions, *viz.*, the Earth's rotation. As the Earth rotates, the areas of daylight and darkness shift constantly. Thus, in examining the impact of one station on another, it is crucial to know if both are subject to the same conditions (of darkness of light) or if one is in darkness when the other is in light.

3. As is clear from the above discussion, many stations that were able to operate during the day because their groundwave signals did not cause objectionable interference would cause such interference if they operated with the same facilities at night.[8] Unless this

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[6] Some signals are reflected back to earth even during daytime hours. This phenomenon is referred to as "daytime skywave." In certain cases, the potential for interference from daytime skywave signals requires a station to reduce its power during the "critical hours" following sunrise and preceeding sunset.

[7] Although most of the change from one propagation condition to the other takes place during these transitional periods, there are minor shifts during other hours as well. For purposes of the Commission's rules, full daytime conditions are considered to occur two hours after sunrise and full nighttime conditions two hours after sunset.

[8] The degree of this effect varies as a consequence of a number of factors, including the station's power, frequency, directional pattern (if any) and the distances to the other stations on the channel.

difference was taken into account, there would have been vast areas of mutually interfering signals dotted with small islands of service.[9] Clearly, this was an unacceptable allocations approach. On the other hand, the Commission long ago realized that it would have been wasteful to authorize only those stations that could operate on a full-time basis. Because even the most efficient nighttime arrangement would have left an enormous amount of unused space during daytime hours, the Commission concluded that it was necessary to provide the opportunity to operate on a daytime-only basis, even if the station could not be accommodated at night.

4. Recognizing the fact that in many cases daytime operation was the only opportunity for bringing desired AM service, many parties took advantage of the opportunity to obtain daytime-only authorizations. In fact, the demand by these parties was so great that there are now more than 2,400 stations which are licensed for operation only during daytime hours. This is approximately half of the total of U.S. AM stations. While easing current engineering standards governing the granting of nighttime authorizations could give some daytime stations the opportunity for nighttime operation, no feasible change could affect more than a small portion of daytime-only stations. For the remaining stations, any relief would have to come during the pre-sunrise or post-sunset periods.

5. Before 1940, the Commission permitted daytime-only stations to sign on regularly at 6:00 a.m. Since 1940, however, the regular hours of operation for daytime-only stations have been considered to be the hours between local sunrise and local sunset. Each station license contains the specific times of sign-on and sign-off. These times are determined for each month based on the times of local sunrise and sunset as of the fifteenth of the month, with the time being rounded to the nearest quarter-hour.

6. Years ago, the Commission permitted daytime-only AM stations to operate during the pre-sunrise period, and it allowed unlimited-time stations to commence operating using their daytime facilities starting at 4:00 a.m. In both cases, such operations were subject to discontinuance upon complaint by protected stations that objectionable interference was being caused within their protected service areas. Because of the small number of stations then on the air, this did not cause serious problems.

7. By the early 1960's, the number of AM stations broadcasting on the 107 AM channels had exceeded 3,500, of which over 1,500 were daytime-only stations. The substantial increase in the number of daytime-only stations coupled with their extensive use of the early

[9] The two principal ways this was taken into account was through power reductions or directionalization at night so that radiation was sufficiently reduced in order to avoid objectionable interference. In some cases, of course, even these reductions were not sufficient. Where such reduction were inadequate, nighttime operation was not possible.

morning sign-on privilege under the rules adopted in 1940 caused interference conflicts to proliferate to such an extent that the Commission decided to explore the subject again.

8. After considerable study by the Commission, the rule making proceeding in Docket 14419 culminated in a landmark *Report and Order* adopted June 28, 1967 (8 F.C.C. 2d 698) which established the basis for pre-sunrise operations.[10] The Commission focused on providing appropriate pre-sunrise arrangements for Class III stations, but Class II stations which operated on Class I-B Clear Channels were included as well. Since then, the Commission has extended the pre-sunrise rule to cover Class II stations operating on Class I-A Clear Channels.

9. Section 73.99 of the Commission's rules governs pre-sunrise operation by both daytime-only as well as full-time stations which operate with different day and night facilities. Different regulations apply to the various categories of stations involved depending on such matters as the class of station, hours of operation and the frequency on which they operate. Under the provisions of Section 73.99, pre-sunrise authority is available to two groups of stations. The first group consists of Class III stations operating on Regional channels. The second group consists of Class II stations which operate on clear channels and provide protection to the dominant Class I stations on these channels.[11]

10. Generally, Class III stations are able to obtain pre-sunrise authority to begin operation with their daytime antenna systems starting at 6:00 a.m. local time at a maximum power of 500 watts, reduced where necessary to provide full treaty protection to co-channel foreign stations. For Class II stations, the restrictions applied to pre-sunrise operations vary according to several circumstances. In the case of those assigned to the seven Clear channels on which Canada is accorded Class I-A priority under NARBA, pre-sunrise operation generally is not permitted. For those operating on the Mexican Class I-A Clear Channels, interference calculations are required pursuant to Section 73.99(d)(2). For Class II stations operating on the Bahamian Class I-A Clear Channel, Section 73.99 specifies that the Commission will determine the power and hours of operation that are consistent with international agreement. Also, operation on foreign Class I-B Clear Channels is permitted.

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[10] In addition to establishing the domestic conditions for pre-sunrise operations by daytime-only stations, Section 73.99 incorporates limitations found in agreements between the United States and neighboring countries.

[11] There are three categories of Class II stations. Although all operate on Clear Channels, there are differences in the facilities which are available to the full-time categories of Class II-A and Class II-B stations, and there are Class II-D stations which operate on these channels only during daytime hours. This proceeding includes consideration of changes in the requirements governing pre-sunrise operations by all three of these groups of stations.

11. Class II stations generally are eligible to apply for authority to operate pre-sunrise with a maximum power of 500 watts, reduced, where necessary, to provide the requisite protection to domestic and foreign stations. However, Class II stations located east of co-channel U.S. Class I-A stations are not permitted to operate during the pre-sunrise period. Those west of a co-channel Class I-A station may commence operating at the time of sunrise at the Class I-A station. Those within the 0.5 mV/m 50% skywave contour of co-channel Class I-B stations to their east may sign on at sunrise at the easterly Class I-B station, but they must protect the Class I-B station to the west. Class II stations operating on United States Class I-B Clear Channels but not within the latter's 0.5 mV/m 50% skywave contours, may sign on at 6:00 a.m., so long as this does not cause interference to the Class I-B stations.

12. The Commission's rules do not make any provision for the authorization of post-sunset operation with daytime facilities. Thus, with the exception of those stations able to obtain pre-sunrise service authorizations pursuant to Section 73.99 of the Commission's rules, operation with daytime facilities is limited to daytime hours. Notwithstanding the limitations on their licenses and in the Commission's rules, AM stations are permitted to use their daytime facilities during nighttime hours to broadcast emergency information. Such operations are governed by Section 73.1250 of the Commission's rules and, in particular, by paragraph (f) of that rule. Under this provision, daytime facilities may be used to broadcast emergency information when necessary to protect the safety of life and property, provided that regular, unlimited-time service is non-existent or inadequate. This response to emergency situations is not limited to pre-sunrise hours but is permissible whenever the emergency arises and the terms of Section 73.1250 are met. Although this rule provides a way for these stations to respond to the need for the broadcast of emergency information, it does not offer any means that could be used to respond to the day-to-day need for service during important hours of the day. Addressing that need is the key focus of this proceeding.

Overview of the Notice of Proposed Rulemaking

13. Although it was unrealistic to expect complete relief from the problems affecting daytime-only AM stations, the Commission did believe that it might be able to relieve many of the current restrictions. To this end it invited comments on the desirability of a series of changes in existing rules. Two of the proposed changes involved relieving current restrictions on pre-sunrise operations; two

concerned the authorization of post-sunset operation and the final proposed change dealt with the use of diurnal curves[12] for both pre-sunrise and post-sunset interference calculations. The specific proposals were as follows:

(1) Permit pre-sunrise operation by Class II stations located east of co-channel Class I-A stations;

(2) Permit Class II stations located outside the 0.5 mV/m 50% skywave contour of co-channel Class I-A stations located to the east of them to begin pre-sunrise operation at 6:00 a. m. local time;[13]

(3) Permit Class II-D (Daytime) stations located outside the 0.5 mV/m 50% skywave contour of co-channel Class I stations to operate past sunset until 6:00 p.m. local time, with a maximum power of 500 watts;[14]

(4) Permit Class III daytime-only stations to operate past sunset until 6 p.m. local time, without protecting other Class III stations, using 500 watts power; and

(5) Adopt the use of diurnal curves for calculating protection requirements for both pre-sunrise and post-sunset periods.

14. *Pre-Sunrise Operation*—The pre-sunrise proposals were designed to explore removing some of the current restrictions on such operations contained in Section 73.99. In particular, the restrictions affect Class II daytime or unlimited-time stations on U.S. Class I-A Clear Channels. These Class II stations have to provide greater protection to the dominant Class I-A stations on the channel than has to be provided to the dominant U.S. Class I-B stations on their channels. Moreover, Section 73.99(a)(i) actually precludes pre-sunrise operation of the Class II station if it is located to the east of the dominant[15] co-channel Class I-A station. The original premise for this limitation was that Class I-A stations were designed to have exclusive use of their channels at night. Now that this exclusivity has come to an end, the Commission proposed to amend Section 73.99 to allow pre-sunrise operation so long as appropriate protection to the Class I-A station was provided.

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[12] "Diurnal", meaning "daily", here refers to the effects on signal propagation characteristics that accompany the change from daytime to nighttime conditions or vice versa.

[13] Section 73.99(b)(3) of the Commission's rules currently permits pre-sunrise operation by these stations, but such operation cannot begin until sunrise at the Class I station to the east if that occurs after 6:00 a.m.

[14] Those inside the 0.5 mV/m 50% skywave contour of Class I stations located to the west of the daytime-only station would have to cease operations at 6:00 p.m. local time or sunset at the Class I station, whichever is earlier. Protection to co-channel Class I stations would be required, using diurnal curves, but the Class II-D stations would not be required to provide post-sunset protection to other Class II stations, nor would they be entitled to post-sunset protection from other stations.

[15] Originally, pre-sunrise authority was not available to these stations at all regardless of their respective locations. However, this aspect of the rule was eased by the *Report and Order* in Docket Nos. 17562 *et al.*, (18 F.C.C. 2d 705, 1969). Because more than one rule making proceeding was involved, that decision also carries the designation of "*Second Report and Order* in Docket No. 18023".

15. In addition, Class II stations to the west of the Class I-A station also faced a limitation, albeit a lesser one. They could not begin pre-sunrise operation until sunrise at the Class I-A station east of them. Depending on the time of year and the east-west distance between the stations, this limitation could have a small or large impact on the pre-sunrise operation. Instead of the current limitation, the Commission proposed to allow all Class II stations outside the 0.5 mV/m 50% skywave contour of co-channel Class I-A stations to begin pre-sunrise operation at 6:00 a.m. local time so long as no interference were caused to the 0.5 mV/m 50% contour of the dominant station. If adopted, these changes would end up treating Class II stations on Class I-A channels in a manner consistent with their treatment on Class I-B channels.

16. *Post Sunset Operation* —The Commission's current rules make no provision for post-sunset operation. With this in mind, the Commission decided to explore the possibility of providing post-sunset relief for daytime-only stations by adopting an approach that paralleled the one employed during the pre-sunrise period. Under this proposal, Class II-D (daytime) and Class III daytime stations would be allowed to operate until 6:00 p.m. local time with a maximum of 500 watts power. Protection to co-channel Class II or Class III stations would not be required, but Class II stations would be required to accord protection to the dominant Class I station on their channel. This would mean that Class II-D stations located outside the 0.5 mV/m 50% skywave contour of the dominant Class I-A or Class I-B station would be permitted to obtain post-sunset authority enabling the station to operate from sunset until 6:00 p.m. local time. Other Class II-D stations could operate (with daytime or critical hours facilities) from sunset until 6:00 p.m. local time or sunset at the nearest Class I station located west of the Class II station, whichever is earlier. In so doing the Class II-D station would have to provide protection to the 0.5 mV/m 50% skywave contour of Class I stations to the east of the Class II station. Finally, the Commission sought comments on providing similar relief to full-time Class II stations so that they could operate with daytime mode and 500 watts power.[16]

17. *Diurnal Curves* —In addition to the proposed changes in the rules directly affecting hours of operation, the Commission invited comments on the use of diurnal curves in making the calculations that would be involved in determining whether interference would

[16] Various Class II full-time stations operate with different modes day and night and critical hours where required. Typically, these stations operate with greater power during the day, often without having to employ a directional antenna pattern. At night, power is reduced and the station is forced to directionalize. Thus, the proposal would be advantageous to full-time Class II stations by allowing them to use their non-directional daytime pattern, albeit limited to 500 watts power or such lesser figure as is necessary in order to avoid interference.

be caused during the pre-sunrise and post-sunset operating periods. Diurnal curves depict the changing propagation conditions that obtain as night changes into day and as day changes into night. In this regard, it is important to recognize that the rate of increase in skywave propagation as dusk approaches is not the same as the rate of reduction as dawn approaches. Thus, two entirely different sets of curves would be required to depict the propagation conditions obtaining during the particular segment of the two hour periods immediately before and after sunrise and sunset.

18. The diurnal curve proposal originated from a suggestion made by NTIA in its petition where it urged the adoption of the curves contained in CCIR Recommendation 435–3.[17] Sections 73.187 and 73.190 rules already contain a provision used in computing daytime skywave intereference to Class I stations. The use of diurnal curves in connection with pre-sunrise operations previously was rejected by the Commission in Docket 14419 as unnecessary for the pre-sunrise rules being adopted. However, in light of the proposals for extended hours of operation, particularly during the post-sunset period, the Commission believed that diurnal curves could perform a useful service, and two sets of curves (one each for sunrise and sunset) were proposed. Although based on earlier curves considered by the Commission, the newly proposed curves had been refined and made more accurate. As proposed by the Commission, the curves would be used by Class II-D and Class III daytime stations in determining permissible power during the proposed post-sunset operating period and would be used as appropriate during the pre-sunrise period as well. Although there are changes in permissible power during the year, the Commission did not believe that it was feasible to have different operating power for each month of the year. Instead, use of a "worst case" approach was proposed, with that power being applied year-round.

DISCUSSION

19. After careful review of the entire record of this proceeding, the Commission has concluded that important relief from current restrictions on hours of operation can be provided consistent with sound engineering practice.[18] First of all, some of the Class II

[17] The diurnal curves recommended by CCIR, the International Radio Consultative Committee, are normalized with respect to the reference hour at Midnight, whereas the curves proposed by the Commission are normalized with respect to the second hour past sunset (SS+2). Additionally, the curves proposed by the Commission are further refined, for example, by taking into account the effects of frequency.

[18] In addition to reviewing the filings in this proceeding, the Commission made extensive use of its computer capacity to examine the impact of the various proposals so that their respective gains and losses could be compared. A Summary of the Comments is contained in Appendix 3 and a list of the parties filing them is found in Appendix 4. In the discussion below, particular reference is made to

stations now excluded from pre-sunrise operation with daytime antenna systems will be able to conduct such operations. Second, Class II and Class III daytime-only stations will be able to operate during the post-sunset transitional period (which extends until two hours after sunset) subject to limitations designed to avoid interference. Finally, diurnal curves are adopted for use in making pertinent interference calculations. Because the use of diurnal curves is central to several of the changes being adopted, we will turn first to that subject. After that discussion, we shall turn to a consideration of the groups of stations affected by our actions, first the Class III stations and then the Class II.

20. *Diurnal Curves* —From our review of the record it is clear that diurnal curves should be used in making pertinent interference calculations under the protection standards being adopted. The curves offer the clear advantage of more accurately depicting the conditions that prevail during the transitional periods. In this regard, CCBS took exception to the Commission's proposal not to use diurnal factors greater than one.[19] It proposed that diurnal factors greater than one should be used for those portions of the two hour period preceeding sunrise when the factor exceeds one. This suggestion fails to recognize that the propagation curves which are contained in Section 73.190 of the Commission's rules represent average conditions existing during the second hour following sunset (SS+2), which is used as the reference hour. The Commission's rules have relied upon these curves to determine interference throughout the nighttime hours. Not only is CCBS's argument inconsistent with long established practice, it would lead to providing greater protection during transitional hours than is now provided during full nighttime hours. We see no justification for such a result and are, therefore, adopting diurnal curves that have been redrafted to show no diurnal factor greater than one.

21. Finally, in adopting the diurnal curves the Commission has recognized the need to facilitate calculations by use of computer programs. Thus, polynomial equations have been developed for each diurnal curve, and the polynomial with a table of constants is being included in the rules. Although the curves themselves are included for reference purposes, the rules have been written to make calculations using the equations controlling. By so doing, ambiguities and questions of accuracy in reading the curves can be eliminated.

22. *Regional Channels* —The Commission did not propose

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several of the filings, namely those of the Daytime Broadcasters Association ("DBA"), the Clear Channel Broadcasting Service ("CCBS"), the Association for Broadcast Engineering Standards ("ABES"), and Cox Communications, Inc., ("Cox").

[19] The diurnal factor of one is the level of skywave propagation used for calculations under full nighttime conditions. Thus, a factor greater than one would represent a value in excess of this level.

changes in the rules concerning pre-sunrise operation by Class III stations and none are included here. The thrust of our *Notice* affecting Class III daytime-only stations dealt with the matter of post-sunset operation by these stations. Class III daytime-only stations represent the largest single category of daytime-only stations that would stand to benefit from rules permitting post-sunset operation. In fact, nearly 1300 of the daytime-only stations (more than 50% of the total) operate on the Regional Channels. As proposed in the *Notice*, these stations would be able to operate during the post-sunset period (until 6:00 p.m.) with 500 watts power; and they would not have to provide interference protection to full-time Class III stations.

23. DBA believed that the Commission's proposal did not provide sufficient relief for the problems faced by daytime-only stations. It argued in favor of permitting post-sunset operation to continue until two hours past sunset, except in cases where there was a showing by a full-time station that such operation would unduly interfere with its broadcast signal. DBA also recommended that daytime-only stations be permitted to operate with power in excess of 500 watts if the protection standards were met. However, DBA did not include any studies to demonstrate the nature of the public benefits it expected to flow from following its recommendations, nor did it submit any interference studies to show gains versus losses which would occur if its recommendations were adopted. Without such support we are unable to conclude that such an approach would serve the public interest. Moreover, as discussed below, even the Commission's own proposal poses serious problems in this regard as has been shown by Commission studies regarding the effects of post-sunset operation. Thus, some modification is necessary in order to avoid excessive loss of service. With this in mind, there is no choice but to reject the DBA proposals.

24. Although most of the commenting parties generally supported the concept of post-sunset operation by Class III daytime-only stations, many said that it was important to provide interference protection to full-time stations. In fact, some parties such as ABES asserted that adoption of the Commission's proposal which does not include such protection could result in massive new interference to existing nighttime primary services. Moreover, many listeners to these stations are said to rely on such service to provide vital information and entertainment services. Thus, the Commission is urged to require daytime-only stations operating during the post-sunset period to directionalize or reduce power sufficiently to provide protection to full-time stations.

25. The Commission's staff has performed extensive additional analysis of the proposal to permit daytime-only stations to operate with 500 watts until 6:00 p.m. without regard to co-channel protection. These studies were performed on 600 kHz and 1380 kHz

because they were believed to be representative Regional Channels to use in examining operations at opposite ends of the AM broadcast band. The results of these studies are shown in Appendix 1, Figures 1–2. From this analysis it is clear that the original proposal carries with it the potential for causing very substantial interference to existing primary sevices. This can be seen especially during the months of December and January, when the daytime only stations would be operating the longest period of time past sunset. The studies show that a number of full-time stations would receive significant interference resulting in substantial loss of primary service. For example, it is estimated that WMT, Cedar Rapids, Iowa, and WREC, Memphis, Tennessee, would lose 4,859.12 square miles and 9,711.40 square miles of service, respectively. Overall it is further estimated that on these two channels alone, 25,766.48 square miles of service would be lost by full-time stations, whereas only 4,493.34 square miles of service would be provided by the daytime-only stations operating post-sunset.

26. Even more important than the loss itself is where it would take place. Often, it could lead to the loss of the only local service available to listeners. Moreover in many cases the service to be provided by the daytime-only station would not provide a substitute for the areas of service that are lost by the full-time station. Multiplying these findings by the overall number of Regional Channels leads us to conclude that our initial proposal for across the board 500 watts post-sunset operation by daytime-only stations would result in unacceptable levels of interference and attendant losses of primary service to local communities and surrounding rural areas.

27. This concern about the impact of the original proposal led us to explore other alternatives, including the recommendation made by several commenting parties that full-time stations receive full protection. In order to study the benefits and effects of such an approach the Commission computed the maximum operating power for each of the daytimers on 600 kHz and 1380 kHz that would fully protect co-channel full-time stations. The results of these studies are shown in Appendix 1, Figure 3. In performing these studies it was assumed that each daytime-only station would be operating until 2 hours past sunset at its location. Moreover, in making the interference calculations diurnal factors for the path mid-points were used.

28. In examining the service areas available to the stations using the particular power level required to avoid interference, it should be understood that the estimated service areas shown in the Appendix represent the "worst case" service that would be provided at 2 hours past sunset. Service at other times would be notably better immediately after sunset when received interference is at a minimum. From that point until two hours after sunset the service areas

would steadily decrease until the "worst case" condition is reached 2 hours past sunset.

29. As a practical matter, it is expected that the daytime-only stations would provide some degree of additional "useful" service greater than that recognized by the Commission's rules. The Commission has no technical standards to describe such additional "useful" service, but it would not be unreasonable to expect that service would be provided out to the groundwave contour limited by interfering signals calculated using 50% propagation curves rather than 10% curves as is the Commission standard. As a point of interest, use of 50% curves for calculating interference is the standard in most of the countries in the western hemisphere. An RSS limit based upon 50% curves is approximately 8 dB less than a limit based upon 10% curves (e.g., a 15 mV/m RSS limit calculated using 10% curves equates approximately to 6 mV/m using 50% curves). Such additional service beyond that predicted by the FCC rules is subject to greater interference, but if the daytimer is providing important information or programming of particular interest to listeners, such interference might be tolerated by listeners.

30. The results of our studies have led us to conclude that daytime-only stations will be able to provide meaningful service to their communities when operating with power reduced sufficiently to provide full protection to co-channel full-time stations. To exemplify this, we have included Figures 4 and 5 in Appendix One showing typical service that would be provided by KZUL, Parker, Arizona and WRAB, Arab, Alabama, at 1 hour and 2 hours post-sunset. These exhibits show that even with the considerable reductions in power required for these two stations, they will be able to provide significant coverage. Because operation with 500 watts is not a prerequisite to effective coverage, there is all the more reason to adopt a system that takes the serious interference potential into account. Under the approach we are adopting, proper attention can be paid to both concerns: the need for extended hours of operation and the need to avoid the loss of existing services. Accordingly, we are adopting rules that will require full protection of full-time stations.[20] For this purpose the existing nighttime RSS limit of the full-time station, together with the 50% exclusion rule, will be used

[20] Although protection would be offered to full-time stations on these channels, the new rules do not contemplate protection for the daytime-only stations operating on these channels during the post-sunset period. If the daytime stations all operated with the same power level of 500 watts, there would be a balance in their impact on one another. However, in light of the fact that many of the daytime-only stations on these channels will have to reduce power below 500 watts, we believe that it is inappropriate to permit other daytime-only stations to use power in excess of 500 watts as has been suggested. Adopting such an approach could result in increased interference to stations operating at reduced levels, thereby depriving them of the very benefits the rule was designed to provide.

in determining permissible power for the daytimer during post-sunset hours.

31. Use of full protection standards offers the opportunity to provide additional relief to the daytime-only stations. Under the original proposal, post-sunset operation was to extend from sunset until 6:00 p.m. During some times of the year, sunset occurs after 6:00 p.m. local time so that the station would have received no benefit from the rule during those months of the year. In other months, the period from sunset to 6:00 p.m. would be quite short, so the station would receive only minimal benefit. Such a restriction made sense if the effects of interference were not to be taken into account. Now that we have decided to accord full interference protection to full-time stations, we see no reasonable basis for denying daytime-only stations the opportunity to further serve the public by extending their operation until 2 hours past sunset throughout the year.

32. Although we have received several other suggestions in regard to extended hours for Class III stations, we do not believe that they warrant adoption. NAB has suggested that daytimers be permitted to apply for and use directional antennas specifically designed to provide protection during the period of extended hours. We do not think that this would be practical because extended hours must be considered a secondary type of operation, one which is not protected and which is subject to modification to eliminate objectionable interference. Furthermore, it is anticipated that the power daytime-only stations use during extended hours operations will have to be recalculated periodically to reflect the necessary adjustments in power needed to protect newly authorized full-time stations and other changes occurring on the channel.

33. With regard to the suggestion that was made by several commenting parties that post-sunset power be calculated for consecutive 15 minute or 30 minute periods and that stations be permitted to readjust their power for each of these periods, we do not think that this is feasible. This increases both the technical and operational complexity during extended hours and increases the potential that objectionable interference could be caused either by technical malfunction, misadjustment, or operator error. Also, the rules for Class III stations will be made based on calculations reflecting the most restrictive time of the year when it is 2 hours past sunset at the daytime-only station site, and this power will be used throughout the year.[21] Finally, the calculations will take into account the diurnal factors determined at the path mid-points.

34. *Class II-D Station*—We next turn to our proposals concern-

[21] Our studies have shown that variations in the permissible power from month to month is not significant. Thus, use of the most restrictive month has the advantages of simplicity and certainty while at the same time avoiding any significant impact on daytime-only stations.

ing extended hours of operation by Class II-D (daytime) stations on the Clear addition to the proposals in our Notice, the Commission received other suggestions, arguing in favor of greater or lesser protection for Clear Channel stations than had been proposed.

35. DBA proposes that the FCC should simply allow all daytime-only stations to operate from two hours before sunrise until two hours past sunset. However, DBA did not submit any technical data to support its proposal. Moreover, the system DBA advocated would cause the loss of very important signals to a large audience in many parts of the country. In good measure, these are people who are unable to receive primary service from any station and thus must depend on the skywave service provided by Clear Channel stations. We cannot ignore such an impact, nor in the absence of any data on the point, can we conclude that the impact would be otherwise.

36. DBA also suggested several alternatives concerning the degree of protection to be provided skywave service. It is clear from the nature of the DBA proposals that they would have the effect of seriously degrading the nighttime skywave service of Class I stations. Because of this impact, we do not believe that these proposals merit further consideration or detailed discussion. In this regard it is instructive to note the Commission's *Report and Order* in Docket 20642.[22] In that proceeding, after many years of study which included many of the same issues now being raised by DBA concerning the need for and protection of nighttime skywave service provided by Class I stations, the Commission reached a carefully balanced decision that preserved nighttime skywave service of Class I-A stations out to the 0.5 mV/m 50% skywave contour. Since DBA did not include in its comments any supporting data that would lead us to believe that the basis of our decision in Docket No. 20642 has changed in the short time since our decision was reached, we are still persuaded that the public interest continues to require protection to the 0.5 mV/m 50% skywave contours of Class I stations.

37. On the other side of the issue, CCBS, among others, expressed concern about the cumulative effects of multiple interfering signals at the 0.5 mV/m 50% contour, even if each individual signal is adjusted to protect the contour in accordance with Section 73.182 of the FCC rules. Therefore, it recommended that multiple interfering signals be combined using the root-sum-square principle (RSS) and that the RSS would not be permitted to exceed 0.5 mV/m at the protected contour.[23] Multimedia noted that the same situation

[22] 78 F.C.C. 2d 1345 (1980); reconsideration granted in part, denied in part, 83 F.C.C. 2d 216 (1980); affirmed *sub nom. Loyola University v. F.C.C.*, 670 F. 2d. 1222 (D. C. Cir.) (1982).

[23] Section 73.182 of the rules does not provide for application of the RSS rule at the skywave contour of Class I stations. Rather, the rules restrict each interfering signal to a maximum of 25 uV/m. Thus, the rules now permit interference to be caused which exceeds an RSS of 0.5 mV/m at the protected contour.

exists under the current rules for pre-sunrise operation, but it thought the impact was less there because the use of full nighttime protection principles provides an extra margin of safety. While Multimedia asserted that similar considerations apply also to full-time Class II stations, it acknowledged that there could only be a relatively few full-time Class II stations that could be accommodated on each channel.

38. In considering whether to use the RSS in calculating interference to the skywave contour, it is enlightening to review the manner in which the skywave contour of a Class I station develops in intensity during the transitional period.[24] For illustrative purposes, we have calculated the extent of the 50% skywave contours for Stations KOA, Denver, Colorado, along several azimuths and for different times of the day during the transitional period beginning at sunset (SS) at its transmitter site and ending at sunset plus 2 hours (SS+2). Curves resulting from these calculations are shown in Figures 6 through 8 of Appendix 1. As can be seen, the 0.5 mV/m 50% contour does not exist at sunset. It gradually builds up, increasing its reach, until at SS+2 the contours on eastern azimuths essentially will be fully developed and their full nighttime predicted distances reached.

39. In recognition of the phenomenon described above, NTIA proposed that determination of permissible power for Class II-D stations should take into account the actual location of the 0.5 mV/m 50% contour at a particular point in time. Through use of computerized techniques this would not be an impossible task. Nonetheless, it is too complex and impracticable to implement. It would be necessary to perform multiple power adjustments throughout the transitional period to reflect the fact that the 0.5 mV/m 50% contour is expanding outward. Earlier in this *Report and Order* we expressed our concern about permitting the use of multiple power levels during the transition period for Regional stations, and that concern applies in this instance as well.

40. We are, therefore, adopting rules which assume that the 0.5 mV/m 50% contour of a Class I station is fully developed after sunset occurs at the Class I transmitter site. We recognize that there is a greater potential for cumulative interference when daytimers are operating post-sunset along with authorized full-time operations. This is so because during such periods there are a greater number of potential interfering sources on the channel than would be normally accomodated during the nighttime hours. Thus, we believe there is a need to provide a margin of safety in protecting the skywave service of the Class I stations during periods of post-sunset operation.

[24] In this regard it should be noted that the diurnal curves which we are adopting could be used in the calculation of 50% skywave signals of Class I stations during the transitional period.

Daytime-only stations will be required to protect the location of this contour, thereby providing a margin of safety in protection of the actual 0.5 mV/m contour as it develops during the transitional period. By the time the protected skywave contour of the Class I station is fully developed, daytime-only stations having the greatest potential for causing interference will already be off the air. Where a 0.5 mV/m 50% signal is not produced, e.g. in the null of some directional antennas, the 0.5 mV/m groundwave contour will be protected on the same basis. We believe that these rules sufficiently provide for protection of the Class I's nighttime service and find no need to further consider use of the RSS in calculating permissible interference to skywave contours.

41. Cox objected to any extended hours of operation by daytime-only stations located within the protected skywave contour of a Class I station. We do not see merit in this objection as long as it is still daytime at the dominant station. Sections 73.7 and 73.182 of the rules make it clear that nighttime is the period between the hours of sunset and sunrise and secondary service is provided during nighttime at which time protection is provided to the 0.5 mV/m 50% skywave contour. Therefore, until sunset occurs at the dominant station, it is deemed to be providing daytime, not nighttime service. If daytime-only stations east of the dominant station and within the protected nighttime skywave contour are permitted to operate until sunset at the dominant station, the issue becomes one concerning the degree of protection to be given the daytime contour of the dominant station. This is an issue that was of concern to several commenting parties and it is discussed in detail below.

42. The Commission recognized in adopting Section 73.187 of the rules that full protection would not be provided to the daytime contours of Class I stations during the critical hours.[25] In fact, in its *Proposed Report and Order Notice of Further Rule Making and Order* in Docket 8333, 10 R.R. 1541 (1954), the Commission stated: "We are aware that such a rule condones a considerable amount of interference in the transitional periods but believe that this interference should be tolerated in view of the overall objectives."

43. To exemplify permissible interference that is already being caused to the 0.1 mV/m groundwave contours of Class I stations, Figure 9 in Appendix 1 was prepared using KOA, Denver, Colorado, as the subject station. The levels of interference shown for each station was that occurring at the particular point on KOA's contour that receives the greatest interference from that station. From this it can be seen that interfering limits approaching 1 mV/m are not atypical when it is at sunset at the Class II station.

44. Another phenomenon that we should also take note of is the

[25] Critical hours are the two hours following sunrise and the two hours preceeding sunset at each Class II station.

skywave interference that a Class I station causes to its own daytime service contour. At a distance from a station such that the groundwave and skywave are similar in strength, considerable distortion in the received program is experienced because of the cancellation from moment to moment of first one side-band frequency then another, including the carrier. This creates the so called "distortion zone" which by usual convention extends from the inner edge, where the ratio of the groundwave signal to instantaneous skywave signal is 2 to 1 to the outer edge, where the ratio of the instantaneous skywave signal to groundwave signal is 2 to 1. This matter was studied in the Hearing in Docket 6742[26] and was included in Exhibit 109 of that Hearing.

45. The Commission performed studies concerning self interference and the results using KOA, Denver, Colorado, as the subject station, are shown in Figures 10 and 11. These figures demonstrate the degree to which KOA's groundwave signal is limited by its own 50% and 10% skywave signals at different times of the day. The 0.1 mV/m daytime contour of KOA along the 65 ° azimuth extends approximately 309 miles. At sunset (SS) at KOA it is seen that the 50% skywave signal has limited the groundwave service along this azimuth to approximately 208 miles and 0.37 mV/m. Similarly, the 10% skywave signal at sunset has limited the groundwave service to approximately 144 miles and 1.1 mV/m. At sunset minus one hour (SS-1), it is seen that the 10% skywave has already limited the groundwave service to 226 miles and 0.280 mV/m.

46. Because the Commission has recognized that considerable interference occurs at the daytime contour of Class I's, we did not propose additional protection standards for this contour in this *Notice*. However, CCBS and others urged the Commission to restrict interference at the 0.1 mV/m from daytimers operating extended hours to 5 uV/m. In view of the substantial interference already caused, as discussed in foregoing paragraphs, we do not believe that such a high degree of protection is justified, especially since it would unduly restrict post-sunset operation. We now believe, however, that some degree of additional protection is warranted to guard against the creation of any new serious interference. We have considered several alternatives ranging from (1) computing the interference limited contour for protection purposes, (2) permitting interference from each daytime-only station during extended hours to equal interference it caused during critical hours, to (3) permitting the daytime-only station to continue operating with its daytime or critical hours facilities, limited to 500 watts, until sunset at the dominant station.

47. The first of these alternatives would be excessively complex

[26] See figure 4, *National Coverage of Standard Broadcast Stations During Nighttime Hours*; T. R. R. Report No. 2. 3. 5., October 1, 1957.

for this application and the other two alternatives would potentially create new interference since multiple interfering signals would be reaching peak levels simultaneously (this would occur at sunset at the dominant station). We have concluded that the solution is to limit the amount of skywave radiation at the 0.1 mV/m contour from any one station operating post-sunset hours to 25 uV/m. This provides a sufficient margin of safety to guard against any new serious interference in two significant respects. First, any single limit will be at most half of the typical levels of interference being caused. Thus, even if multiple interference occurred at any point on the contour, the RSS will remain within typical levels of interference that can occur. Second, as sunset approaches at the dominant station, the dominant station's own skywave signal increasingly limits its groundwave service to distances closer than the 0.1 mV/m contour.

48. Once sunset occurs at the daytime-only station, it will be required to reduce power, using daytime facilities or critical hours facilities if required, sufficiently so that at the time sunset occurs at the dominant station, the daytime-only station is not producing a skywave signal of more than 25 uV/m at any point on the 0.1 mV/m contour of the dominant station. If the daytime-only station is outside the 0.5 mV/m 50% contour, then a further power reduction may be required to protect the skywave contour. Daytime-only stations east of a dominant station and within its protected skywave contour must go off the air at sunset at the Class I. Those west of the dominant station and within its protected skywave contour will not qualify for post-sunset operation.[27]

49. For the purposes of these rules, sunset and sunrise times will be calculated using the coordinates of the transmitter sites involved, and the 0.1 mV/m contour is to be determined on the basis of FCC figure M3, Estimated Effective Ground Conductivity in the U.S. The periods of extended operation will be rounded to the nearest 15 minutes. Using this convention, no daytime-only station will be authorized for extended hours on Clear Channel frequencies unless its extended period, rounded off, is calculated to be 15 minutes or more. In no event will operation beyond 2 hours past local sunset be permitted and in no case may the power exceed 500 watts or daytime power, whichever is lower. Class II-D stations also will be required to fully protect full-time Class II stations in the same way that daytime-only stations on the Regional Channels are required to protect full-time stations. The reasoning for requiring this protection is the same as that given in our discussion concerning the Regional Channels. Thus, further discussion is not warranted here.

[27] Reference to east/west relationship is intended to reflect the relationship of sunrise/sunset of the stations involved rather than a true east/west orientation. Taking this into account, it is estimated that 110 stations will not qualify.

50. *Pre-sunrise Operations, Class II Stations*—The primary intent of the Commission's proposals concerning pre-sunrise operations by Class II stations on the Class I-A Clear Channels was to conform the rules in order to provide the same treatment of Class II stations on the Class I-A Clear Channels as that provided on the Class I-B Clear Channels, and to permit use of the diurnal curves for interference calculations. One of the reasons for this lack of conformity until now is that at the time the rules in Section 73.99 were adopted, the Class I-A Clear Channel stations were afforded a degree of protection that derived from the exclusivity of the Class I-A nighttime priority within the North American Region. However, as indicated in the *Notice*, we eliminated such nighttime exclusivity in 1980 and opened up all 25 of the Class I-A Clear Channels for the assignment of unlimited-time Class II stations that would protect the 0.5 50% skywave contours of co-channel Class I-A stations during nighttime hours. As noted earlier in this *Report*, limited comments were received expressing concern about the Commission's pre-sunrise proposals. However, these arguments were not persuasive and based upon the experience that has been gained over the years with Class II stations operating pre-sunrise on the Class I-B Clear Channels, we believe that it is appropriate to adopt the proposed pre-sunrise rule changes. Although DBA urged the Commission to adopt rules that would permit pre-sunrise operation 2 hours before sunrise year-round, we are persuaded that the listening habits and the justification for more uniform higher power during the early morning hours during the winter months makes our different treatment of pre-sunrise and post-sunset operation justified. Therefore, we must reject DBA's recommendation. Otherwise, we would be compelled to require all stations operating pre-sunrise to provide full protection, something which we believe would be to the detriment of listeners depending upon current pre-sunrise service.

51. *International Considerations*—As we indicated earlier, before the Commission can fully implement most of the changes in the rules relating to extended hours of operation it must take into account several pertinent international agreements and understandings.[28] In fact, except for the proposals to extend pre-sunrise authority to additional Class II stations on U.S. Class I-A Clear Channels, none of the proposals can be fully implemented without reaching agreement with neighboring countries. We are hopeful that the necessary agreements can be reached and that the rule changes we are adopting can be at least partially implemented in the near future, but until this happens, only limited relief can be provided. To clarify the matter, the following is a description of the status of the negotiations and their impact on the rule changes being made. Tentative agreement has been reached with Canada regarding

[28] The agreements are listed in footnote 4, *supra*.

extended hours operations and it will be possible to allow post-sunset operation of Class II-D (daytime) and Class III stations upon exchange of Notes implementing the agreement. Such exchange is now imminent. Protection will be required to Canadian full-time stations by the new agreement. In addition, the tentative agreement provides for the use of diurnal curves in making pertinent interference calculations. Not only does this mean that overall fuller use of the channels will be possible during the post-sunset period, it can make it possible for a number of stations now operating during pre-sunrise hours to employ greater power than has been possible before. Finally, and most importantly, the Canadians have agreed to the use of Canadian Clear Channels for both pre-sunrise and post-sunset operation, using diurnal curves for pertinent calculations. By virtue of this tentative agreement, there no longer appears to be any Canadian impediment to full implementation of the new rules.

52. Unfortunately, it has not yet been possible to obtain agreement with Mexico or the Bahama Islands. Mexican negotiations are actively underway and the Commission is quite hopeful that the negotiations can be brought to a prompt and successful conclusion. In the meantime, however, there is no choice but to delay implementation in several regards. First, it will not be possible to calculate permissible powers using diurnal factors. Also, there is no agreement yet for post-sunset operation extending beyond 6:00 p.m. local time. This means that, except on the U. S. I-A Clear Channels, where the United States has treaty priorities under both the United States/Mexican AM Agreement as well as NARBA, post-sunset operations will be possible for U. S. Class II-D (daytime) and Class III daytime stations only until 6:00 p. m. local time. Finally, negotiations are planned with the government of the Bahama Islands, but until such agreement is reached, no changes can be made in the extended hours use of the Bahamian Clear Channel (1540 kHz).

53. *Procedural Matters*—Although the changes we are making today rest on the simple premise that important relief can be provided consistent with sound engineering practice, the calculations involved are not so simple in all respects. Several parties recommended that the Commission perform the necessary calculations to determine times of extended hours of operation and the maximum power that could be utilized by each station. Because such calculations had to be made by the Commission as part of the decision making process, it was necessary to develop various computer programs needed for making these large scale calculations. With this in mind we have concluded that it is appropriate for the Commission to perform the necessary computations. Doing so could help expedite the bringing of these services to the public and it would reduce the administrative burden on the Commission by eliminating the need to have applications filed for processing. Also, because extended hours operations are secondary, the Commission plans to

do periodic recomputations to determine what adjustments are necessary to protect newly authorized stations or other changes in licensed operations. Current planning suggests that a yearly review would be appropriate. In any case, affected stations would receive a new attachment for their licenses. Here, too, the Commission will not require the station to perform any of its own calculations.

54. Based on the above calculations, the Commission will produce a complete list of daytime-only stations along with the powers they can employ and extended hours periods during which operation will be permitted. In addition to maintaining a master list, the Commission will advise each affected station individually. For all stations that will be able to operate during the pre-sunrise and post-sunset periods, the Commission will provide material to be attached to the station's basic authorization which will set forth the specific operating periods and powers to be employed. However, as noted above, full implementation has to await a final agreement with Mexico. Until that agreement is put into effect, post-sunset operation cannot extend beyond 6:00 p.m. local time. Accordingly, the authorizations will specify that such operation is not to be conducted until advised by the Commission that the Mexican agreement has been implemented. At that point the station will be able to use the full operation as specified in the authorization it is to receive. Also, no operation under the new rules may be conducted until the effective date for the rule changes specified in paragraph 57, below.

55. Because of the nature of the calculation process involved in authorizing extended hours of operation, it is not feasible for the Commission to undertake individual recalculations, nor do we believe that any such recalculation is necessary since the computer programs have been carefully created and fully tested to ensure accurate results. Accordingly, the Commission does not intend to entertain requests from individual stations seeking additional pre-sunrise or post-sunset time or power. The only feasible way for the Commission to handle this subject is through the routinely scheduled periods of review. On the other hand, there may be licensees which believe that specific authorizations would lead to impermissible interference to their service areas. In order for any such objection to be considered, it must be accompanied by a technical showing including *all* the following: the amount of interference (including thereas and populations affected), how the interference was calculated, where the alleged error in the Commission's calculations occurred, and an explanation as to why the interference involverd is not *de minimis*, including maps showing how station coverage is affected. Failure to provide all of this information will result in dismissal of the objection. In addition, any such objection must be served on the offending station which may in turn file a responsive pleading.

56. *Economic Structural Benefits*—Daytime-only AM stations

have always been subjected to limitations in their ability to compete with full-time stations. In fact, these limitations on the hours when they can operate effectively eliminates them from the market during some of the most lucrative portions of the broadcast day. These effects are most pronounced during the winter months when the daylight hours are shortest. As a result of our action relieving many of these restrictions, daytime-only stations will be able to compete more effectively, thus also helping to implement the Commission's mandate to establish a competetive environment within the industry. We believe that such relief is especially important to these stations now that the marketplace of electronic media is expanding and developing new kinds of services and media forms and formats.

57. Accordingly, IT IS ORDERED That, Sections 73.99, 73.185, 73.190, 73.1670, and 73.1735 of the Commission's Rules ARE AMENDED, effective (Insert date of 30 days *after F.R.* date) as set forth in the attached appendix.

58. Authority for this action is contained in Sections 4(i), 303 and 307(b) of the Communications Act of 1934, as amended.

59. *Regulatory Flexibility Analysis*

I. *Need for the Purpose of the Rule*

The rule is designed to provide relief for the more than 2400 AM stations that are limited in their hours of operation. These are the stations which are limited to operation during the hours between local sunrise and local sunset. Although many of these stations are able to operate during at least some of the pre-sunrise hours, none of them are able to operate during the post-sunset period. This can have a serious detrimental impact on these stations, especially during winter hours when the hours of daylight are few. The absence of such authority imposes a serious burden on these small entities and on their communities.

II. *Summary of Issues Raised by Public Comment in Response to the Initial Regulatory Flexibility Analysis, Commission Assessment, and Changes Made as a Result.*

A. *Issues Raised*

As discussed in the body of this *Report and Order*, the major issues related to whether pre-sunrise authority could be extended to an additional group of stations and post-sunset operation by daytime-only stations (or to certain categories of full-time stations) could be permitted consistent with sound engineering practice. The Commission was offered several approaches to a resolution of the matter. Daytime-only stations argued in favor of full relief regardless of the service to be lost by other stations. Full-time stations stressed the need for full protection to existing service.

B. *Assessment*

As discussed above, the Commission agreed that daytime-only stations do face serious handicaps in being able to compete with full-time stations and in being able to bring needed service to their

communities. Likewise, it was clear that the potential for interference from unrestricted extension of the hours of operation of these stations was serious. As a consequence, the Commission decided to adopt a system that made full provision for both of these concerns.

C. *Changes Made as a Result*

The Commission's decision follows the suggestions of the full-time stations in regard to the need to provide protection against interference. As a result, the Commission decided against its original proposal that generally would have allowed daytime-only stations to operate with 500 watts power using daytime antenna facilities until 6:00 p.m. local time. Although some protection for Class I stations would have been provided, this was considered to be insufficient. On the other hand, the Commission concluded that it would be possible to provide more relief than had been proposed originally. Thus, it allowed daytime-only stations to operate until two hours after local sunset. This extends the period of operation well beyond 6:00 p.m. in many months of the year. Operation is to be with 500 watts power, reduced as necessary to avoid interference.

III *Significant Alternatives Considered and Rejected*

The only significant alternatives were those discussed above regarding uniform operating schedule throughout the year and the appropriateness of taking interference calculations into account in determining the power which should be employed during the extended hours of operation. Although the Commission was not able to follow all of the urgings of the daytime-only stations, little of the essence of what it sought was rejected; in fact, in some ways it received even more and without the need for the submission of engineering in most cases.

60. For further information concerning this proceeding, contact Wilson La Follette, Mass Media Bureau, (202) 632–5414 or Jonathan David, Mass Media Bureau, (202) 632–7792

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Appendices 1, 3 and 4; Figures 12 and 13 - may be seen in FCC Docket Branch, 1919 M Street, N.W., Room #239, Washington, D.C. 20554, or at *48* FR *42944*.

APPENDIX 2

1. Section 73.99 is amended to read as follows:

§ 73.99 Pre-sunrise service authorization (PSRA) and Post-Sunset service authorization (PSSA).

(a) To provide the maximum uniformity in early morning operation capatible with interference considerations, and to provide for additional service during early evening hours for daytime-only stations, the provisions are made for pre-sunrise service and post-sunrise service. The permissible power to be assigned in pre-sunrise or post-sunset service authorization will not exceed 500 watts, or the authorized daytime or critical hours power (whichever is less).

(b) Pre-sunrise service authorization (PSRA) will permit:

(1) Class II stations operating on Mexican, Bahamian, and Canadian Class I-A and I-B Clear Channels to commence PSRA operation at 6:00 a.m. local time and to continue such operation until the sunrise times specified in their basic instrument of authorization.

(2) Class II stations situated outside the respective 0.5 mV/m 50% skywave contours of co-channel domestic Class I-A and I-B stations to commence PSRA operation 6:00 a.m. local time, and continue this operation until sunrise times specified in their basic instruments of authorization.

(3) Class II stations located inside a co-channel 0.5 mV/m 50% skywave contours of domestic Class I-A and I-B stations, to commence PSRA operation either at 6:00 a.m. local time, or at the time of sunrise at the nearest Class I station located east of the Class II station (whichever is later), and continue this operation until the sunrise times specified in their basic instruments of authorization.

(4) Class III stations to commence PSRA operation at 6:00 a.m. local time and to continue such operation until local sunrise times specified in their basic instruments of authorization.

(c) Post-sunset service authorization (PSSA) will permit:

(1) Class II-D stations located on Mexican, Bahamian, and Canadian Class I-A and I-B Clear Channels to commence PSSA operation at sunset times specified in their basic instruments of authorization and to continue for two hours after such specified times.

(2) Class II-D stations situated outside the respective 0.5 mV/m 50% skywave contours of co-channel domestic Class I-A and I-B stations to commence PSSA operations at sunset times specified in their basic instruments of authorization and to continue up to two hours after such specified times.

(3) Class II-D stations located inside co-channel 0.5 mV/m 50% skywave contours of domestic Class I-A and I-B stations to commence PSSA operation at sunset times specified in their basic instruments of authorization and to continue such operation until two hours past such specified times, or until the time of sunset at the nearest Class I station located west of the Class II station (whichever is earlier). (Those west of the dominant station do not qualify for PSSA operation.)

(4) Class III daytime only stations to commence PSSA operation at sunset times specified on their basic instruments of authorization and to continue such operation until two hours past such specified times.

(d) *Procedural Matters.*

(1) Applications for PSRA and PSSA operation are not required. Instead, the FCC will calculate the periods of such operation and the power to be used pursuant to the provisions of this Section and the protection requirements contained in applicable international agreements. Licensees will be duly notified of permissable power and times of operation. Pre-sunrise and Post-sunset service authority permits operation on a secondary basis and does not confer license rights. No request for such authority need be filed. However, stations intending to operate PSRA or PSSA shall submit by letter, signed as specified in Section 73.3513, the following information:

(i) licensee name, station call letters and station location,

(ii) indication as to whether PSRA operation, PSSA operation, or both, is intended by the station,

(iii) a description of the method whereby any necessary power reduction will be achieved.

(2) Upon submission of the required information, such operation may begin without further authority.

(e) *Technical Criteria.* Calculations to determine whether there is objectionable interference will be determined in accordance with the AM Broadcast Technical Standards, Sections 73.182 through 73.190, and applicable international agreements. Calculations will be performed using daytime antenna systems, or critical hours antenna systems when specified on the license. In performing calculations to determine assigned power and times for commencement of PSRA and PSSA operation, the following standards and criteria will be used:

(1) Class II stations operating in accordance with (b)(1), (b)(2), (c)(1), and (c)(2) are required to protect the nighttime 0.5 mV/m 50% skywave contours of co-channel Class I stations. Where a 0.5 mV/m 50% skywave signal is not produced, the 0.5 mV/m groundwave contour will be protected.

(2) Class II stations are required to fully protect foreign Class II stations when operating PSRA and PSSA and Class II-D stations operating PSSA are required to fully protect domestic full time Class II stations. For purposes of determining protection, the existing nighttime RSS limit will be used in the determination of maximum power permissible.

(3) Class II stations operating in accordance with (c)(2) and (c)(3) are required to restrict maximum 10% skywave radiation to any point on the daytime 0.1 mV/m groundwave contour of the co-channel Class I station to 25 uV/m. For purposes of performing these calculations the 0.1 mV/m contour of the Class I station will be determined by use of Figure M3, Estimated Ground Conductivity in the United States. When the 0.1 mV/m contour extends beyond the national boundary the international boundary shall be considered the 0.1 mV/m contour.

(4) Class III stations operating PSRA and PSSA are required to provide full protection to co-channel foreign Class III stations. Additionally, Class III daytime only stations operating PSSA are required to fully protect domestic full time Class III stations. For purposes of determining protection, the existing nighttime RSS limit will be used in the determination of maximum power permissible.

(f) Calculations made under paragraph (d) of this Section may not take outstanding PSRA or PSSA operations into account, nor will the grant of a PSRA or PSSA confer any degree of interference protection on the holder thereof.

(g) Operation under a PSRA or PSSA is not mandatory, and will not be included in determining compliance with the requirements of § 73.1740. To the extent actually undertaken, however, pre-sunrise operation will be considered by the FCC in determining overall compliance with past programming representations and station policy concerning commercial matter.

(h) The PSRA or PSSA is secondary to the basic instrument of authorization with which it is to be associated. The PSRA or PSSA may be suspended, modified, or withdrawn by the FCC without prior notice or right to hearing, if necessary to resolve interference conflicts, to implement agreements with foreign governments, or in other circumstances warranting such action. Moreover, the PSRA or PSSA does not extend beyond the term of the basic authorization.

(i) The FCC will periodically recalculate maximum permissible power and times for commencing PSRA and PSSA for each Class II and Class III station. These original notifications and subsequent notifications should be associated with the station authorization. Upon notification of new power and time of commencing operation, affected stations will make necessary adjustments within 30 days.

(j) A PSRA and PSSA does not require compliance with §§ 73.45, 73.182, 73.188, and 73.1560 where the operation might otherwise be considered as technically substan-

dard. Further, the requirements of paragraphs (a)(5), (b)(2), (c)(2), and (d)(2) of § 73.1215 concerning the scale ranges of transmission system indicating instruments are waived for PSRA and PSSA operation except for the radio frequency ammeters used in determining antenna input power.

(k) A station having an antenna monitor incapable of functioning at the authorized PSRA and PSSA power when using a directional antenna shall take the monitor reading using unmodulated carrier at the authorized daytime power immediately prior to commencing PSRA or PSSA operations. Special conditions as the FCC may deem appropriate may be included for PSRA or PSSA to insure operation of the transmitter and associated equipment in accordance with all phases of good engineering practice.

Note: Extended hours operations are subject to international agreements governing all operations. These agreements are in the process of revision, but until this process is completed it will not be possible to allow full operation as outlined above.

2. Section 73.185, Computation of interfering signal, is amended by adding new subparagraph (k) as follows:

* * * * *

(k) In performing calculations to determine permissible radiation from stations operating pre-sunrise or post-sunset in accordance with Section 73.99, calculated diurnal factors will be multiplied with the values of skywave signals for such stations obtained from Figure 1a or Figure 2 of Section 73.190.

(l) The diurnal factor is determined using the time of day at the mid-point of path between the site of the interfering station and the point at which interference is being calculated. Diurnal factors are computed using the formula $D_f = a+bF+cF^2+dF^3$ where:

$D_f$represents the diurnal factor,
F is the frequency in MHz,
a,b,c, and d are constants obtained from the tables in (2)

A diurnal factor greater than one will not be used in calculations and interpolation is to be used between calculated values where necessary. For reference purposes, curves for pre-sunrise and post-sunset diurnal factors are contained in Figures 13 and 14 of Section 73.190.

(2) Constants used in calculating diurnal factors for the presunrise and post sunset periods are contained in (i) and (ii) respectively. The columns labeled T_{mp} represents the number of hours before and after sunrise and sunset at the path midpoint.

(i) *Presunrise Constants*

T_{mp}	a	b	c	d
-2	1.3084	.0083	-.0155	.0144
-1.75	1.3165	-.4919	.6011	-.1884
-1.5	1.0079	.0296	.1488	.-.0452
-1.25	.7773	.3751	-.1911	.0736
-1	.6230	.1547	.2654	-.1006
-.75	.3718	.1178	.3632	-.1172
-.5	.2151	.0737	.4167	-.1413
-.25	.2027	-.2560	.7269	-.2577
SR	.1504	-.2325	.5374	-.1729
+.25	.1057	-.2092	.4148	-.1239
+.5	.0642	-.1295	.2583	-.0699

+.75	.0446	−.1002	.1754	−.0405
+1	.0148	−.0135	.0462	.0010

(ii) *Post Sunset Constants*

T_{mp}	a	b	c	d
1.75	.9495	−.0187	.0720	−.0290
1.5	.7196	.3583	−.2280	.0611
1.25	.6756	.1518	.0279	−.0163
1.0	.5486	.1401	.0952	−.0288
.75	.3003	4050	−.0961	.0256
.5	.1186	.4281	−.0799	.0197
.25	.0382	.3706	−.0673	.0171
SS	.0002	.3024	−.0540	.0086
−.25	.0278	.0458	.1473	−.0486
−.5	.0203	.0132	.1166	−.0340
−.75	.0152	−.0002	.0786	−.0185
−1.0	−.0043	.0452	−.0040	.0103
−1.25	.0010	.0135	.0103	.0047
−1.5	.0018	.0052	.0069	.0042
−1.75	−.0012	.0122	−.0076	.0076
−2.0	−.0024	.0141	−.0141	.0091

3. *Section 73.190, Engineering Charts, is amended by deleting Figure 12 and by adding new Figure 12 and new Figure 13.*

4. Section 73.1670 is amended by revising subparagraph (a)(4) to read as follows:

Section 73.1670 Auxiliary transmitters

(a) * * *

* * * * *

(4) The transmission of regular programs by an AM station authorized for Pre-sunrise (PSRA) and/or Post-sunset (PSSA) operation.

* * * * *

5. Section 73.1735 is revised in its entirety to read as follows:

Section § 73.1735 AM station operation pre-sunrise and post-sunset.

Certain classes of AM stations are eligible to operate pre-sunrise and/or post-sunset for specified periods with facilities other than those specified on their basic instruments of authorization. Such pre-sunrise and post-sunset operation is authorized pursuant to the provisions of § 73.99 of the Rules.

Authority Delegation of, by FCC
FCC Jurisdication, See also Forum
Interlocutory Ruling Appeal From

Authority delegated to General Counsel in hearing proceedings to dismiss: (1) unauthorized interlocutory appeals, and (2) requests for substantive relief which Commission may not grant because jurisdiction over proceeding has terminated.
–Amendment of Part O

FCC 83–561

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of Amendment of Section 0.251 of the Commission's Rules and Regulations, Delegations of Authority to the General Counsel

ORDER

(Adopted: November 28, 1983; Released: November 30, 1983)

BY THE COMMISSION:

1. The Commission has determined that the General Counsel should be authorized in hearing proceedings to dismiss two types of pleadings not warranting Commission consideration. These are: (1) interlocutory appeals not authorized by the Commission's Rules, and (2) requests for substantive relief which the Commission may not grant because its jurisdiction over the proceeding has terminated.[1] The delegation of this authority to the General Counsel will contribute to the proper functioning of the Commission and to the prompt and orderly conduct of its business.

2. Authority for this amendment is contained in Section 4(i) and (j), 5(c) and 303(r) of the Communications Act of 1934, as amended.[2] Because the amendment relates to matters of procedure and internal

[1] While cases are pending before a court, parties should continue the purely ministerial reporting of information to the Commission pursuant to Section 1.65 of the Rules. *RKO General, Inc.*, 42 RR 2d 433 (1978). Substantive matters should be confined to communications with the General Counsel as the Commission's legal representative. *Folkways Broadcasting Co., Inc.*, 61 FCC 2d 912, 914 n.7 (1976). *See also White Mountain Broadcasting Co.*, 66 FCC 2d 672, 673–74 (1977) (concurring statement of Commissioner Margita E. White).

[2] 47 U.S.C. §§ 154(i) and (j), 155(c), and 303(r).

organization, the procedural and effective date provisions of Section 4 of the Administrative Procedure Act[3] are inapplicable.

3. ACCORDINGLY, IT IS ORDERED, That on the date that this Order is published in the Federal Register, Section 0.251 of the Commission's Rules and Regulations IS AMENDED as set forth in the Appendix hereto.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX

In Part O of Chapter 1 of Title 47 of the Code of Federal Regulations, Section 0.251(g) is revised as follows and redesignated 0.251(h) and the following new 0.251(g) is added:

0.251 Authority delegated.

* * * *

(g) The General Counsel is delegated authority in hearing proceedings to dismiss:

(1) interlocutory appeals to the Commission of actions taken under delegated authority when the appeal is not authorized by the Commission's Rules.

(2) requests for substantive relief by the Commission which the Commission may not grant because its jurisdiction over the proceeding has terminated.

(h) The official record of all actions taken by the General Counsel pursuant to §§ 0.251(f) and (g) is contained in the original docket folder, which is maintained by the Secretary in the Dockets Branch.

[3] 5 U.S.C. § 553.

AM Station, Technical Standards
Rules, Amendment of

Section 73.52 of rules amended regarding relative phase tolerances for directional AM Stations. Section 73.68 amended to expand use of toroidal transformers and to provide for use of radio frequency relays in sampling element transmission lines. Outmoded rules and procedures revised or eleminated.
–*Amendment of Part 73* BC Docket No. 78–28

FCC 83–572

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
Amendment of § 73.52 of the Commission's Rules and Regulations with respect to relative phase tolerances for directional AM stations.	BC Docket No. 78–28
Amendment of § 73.68 of the Rules to expand the use of toroidal transformers as a method of deriving current samples in directional (AM) antenna systems; and, to provide for the use of radio frequency relays in sampling element transmission lines.	MM Docket No. 83–16 RM-3103 RM-3740

REPORT AND ORDER
(PROCEEDINGS TERMINATED)

(Adopted: December 1, 1983 Released: December 20, 1983)

BY THE COMMISSION:

Introduction

1. For reasons of administrative efficiency and because the above-referenced proceedings essentially are concerned with the accuracy and stability of directional AM broadcast station antenna systems and associated monitoring equipment, we wish to bring the two proceedings to a conclusion by means of this single *Report and Order*.

BC Docket No. 78–28

2. On January 25, 1978, the Commission adopted a *Notice of Proposed Rule Making* ("*78–28 Notice*") in BC Docket No. 78–28 (43

Fed. Reg. 4647, February 3, 1978) seeking to formalize a policy that required the relative phases of directional AM station antenna currents to be maintained within ±3° of the specified values. The rules did not (and still do not) specify the accuracy within which the phases of the currents should be maintained. Only in cases where there are unusually rigid requirements for the protection of other stations does the station license specify the limits within which phase relationships must be maintained. Accordingly, the Commission proposed to amend then §73.52 (now §73.62) to require licensees of AM stations with directional antenna systems to maintain the phases of the antenna currents within ±3° of the values specified in the station license, unless more stringent limits are specified therein.[1] Comments were filed by the Association of Federal Communications Consulting Engineers (AFCCE), E. Harold Munn, Jr. & Associates, Inc. (Munn), American Broadcasting Company (ABC), National Association of Broadcasters (NAB), Association for Broadcast Engineering Standards, Inc. (ABES) and David C. Williams. No reply comments were filed.

Comment Summary

3. The AFCCE, Munn and ABES support the proposal to adopt a tolerance of ±3° for directional AM stations. ABC questions whether there is really a need to formally codify the existing policy, but agrees that a ±3° tolerance appears reasonable as a general matter. ABES contends that regulation of antenna monitor current amplitudes without similar regulation of antenna phase relationships is anomalous and that all applicable standards should be set forth in the rules. Nevertheless, ABES suggests that adoption of a ±5° tolerance might be more appropriate if such deviation resulted in no additional interference to the service areas of other stations. Lastly, all of these parties emphasize that the final rule should clearly indicate that licensees would be expected to maintain the ±3° phasing tolerance only during periods of normal operation, not during periods of extreme weather or unusual climatic conditions.

4. NAB believes that neither internal (*i.e.*, antenna monitor indications) nor external (*i.e.*, monitoring point field strength indications) indications can be relied upon exclusively to provide complete information about the operating condition of the antenna array because of potentially significant environmental changes possible in either the antenna array or monitoring point environments. Nevertheless, NAB recommends that if changes are contemplated in the regulation of directional antenna systems, either

[1] By reregulatory *Order* adopted September 27, 1979 (FCC 79–609), the FCC divided the subject matter ("Maintenance of antenna input power and directional antenna parameters") of §73.53 between new §§73.62 ("Directional antenna system tolerances") and 73.1560 ("Operating power tolerance"). Thus, the pertinent rule section for the purposes of this proceeding is §73.62.

internal or external indications should prevail, but not both simultaneously. NAB suggests that if we prefer to rely more heavily on internal antenna indications, a substantial relaxation of the requirements pertaining to external indications would be appropriate. Thus, NAB argues that if the ±3° phase tolerance is adopted as the general rule, a 25% tolerance should be applied to the monitoring point values.[2] Further, NAB indicates that a significant number of stations rely on flexibility in antenna phase relationship to make seasonal adjustments to the antenna pattern in order to obtain correct monitoring point values. Such phase adjustments are apparently viewed as an "escape valve" by which broadcasters can avoid having to continually apply for special temporary authorization to operate outside of license-specified parameters. NAB, like ABES, also favors relaxed phase tolerances if applicants or licensees are able to show that operation within the expanded tolerances would result in no additional interference to other stations.

5. Williams does not favor adoption of the ±3° phase tolerance for a number of reasons, and prefers that we pursue a more comprehensive plan designed to ensure proper directional antenna operation. He expresses concern that if we adopt a formal phase angle tolerance, we will attach more importance to it than to field strength, which he considers the final measure of proper antenna operation. Further, Williams demonstrates that antenna arrays with sharp nulls can experience severe distortion of the pattern (particularly in the depth and direction of critical nulls) with phase deviations of ±3°. Thus, he views phase parameters alone as a poor measure of antenna performance. Like the others filing comments, he points out that antenna phase may shift considerably depending on temperature and humidity. This shifting is aggravated, he notes, when the sampling system is poorly constructed and maintained. As an alternative to our proposal, he recommends implementation of a program containing the following elements: additional antenna monitor and field strength measurements when the 5% ratio tolerance and ±3° phase angle tolerance are exceeded; additional skeleton and partial proofs of performance required as necessary; submission of a "proof of performance of the sampling system" after construction or major repairs to the sampling system; mandatory upgrading of sampling systems when deemed necessary; or upgrading of all sampling systems by a specified date.

Discussion

6. We continue to believe that specification of an antenna phase tolerance in the rules is desirable. Proper directional antenna operation can be assumed only when antenna amplitudes and phases

[2] The rules now require that the field strength values not exceed the maximum monitoring point values specified in the station authorization.

are within specified parameters. As ABES points out, it is anomalous that such a tolerance is lacking in the rules when a tolerance exists for antenna current amplitude ratios.

7. As we indicated in the *78–28 Notice*, the ±3° tolerance approximates the current ±5% tolerance applicable to antenna current amplitude ratios. It does not appear that this value would be difficult to maintain, particularly if deviations therefrom are permitted during periods of unusual weather or severe climatic conditions. In this regard, we note that there are a few directional AM stations that are required to hold their relative antenna phases to within 0.5° of the authorized values, and these stations are able to do so using FCC-approved sampling systems and precision antenna monitors. Accordingly, we conclude that as a general rule, operation in accordance with the proposed ±3° phase tolerance is appropriate.

8. Moreover, we disagree with NAB's contention that recent improvements in antenna sampling systems alone do not justify imposition of a ±3° phase tolerance. We take the view that in many cases where an approved antenna sampling system was not used, the actual antenna radiation pattern tended to be more stable than the indications of the antenna sampling system. Any measurement device must be more accurate than the tolerance applicable to the parameter it is being used to measure. This is why we have found it necessary, in various proceedings, to encourage improvements in the quality of both the antenna sampling system itself, and the antenna monitor. We have provided various incentives for AM broadcasters to upgrade the quality of their antenna sampling systems for some time.[3] Yet 35% of directional AM stations still operate with sampling systems of uncertain quality.

9. We believe that monitoring point measurements and internal antenna operating parameters (current ratios and phase) are equally important in determining proper directional antenna operation. The two types of measurements act as a good check and balance system. Only a full proof-of-performance could conclusively demonstrate proper directional antenna operation and this is a very costly and time consuming process. The indications provided by the comparatively few monitoring points specified in the station authorization may vary with changing ground conductivity and may not always reflect the unattenuated radiation. They are also susceptible to reradiation from nearby objects. Further, we require that only a few radials be monitored and these may not conclusively demonstrate that the proper antenna pattern is being obtained. Lastly, we set

[3] Most recently, see the *Report and Order* BC Docket No. 82–537, which eliminated most broadcast periodic measurement and logging requirements. However, the rules required that broadcasters without approved sampling systems continue periodic measurement and logging of those operating parameters concerned with directional antenna operation. See §73.1820(a)(2).

only upper limits for monitoring point indications, but indications which are too low may also indicate misadjustment.

10. The operating values for the antenna current ratios and phases (the internal antenna monitoring parameters) specified on an authorization are established as the result of an extensive proof-of-performance made on the antenna system. Unlike monitoring point field strength indications, antenna monitor indications are easy to obtain on a frequent basis and are often more reliable, being less susceptible to the effects of local environmental changes. Experience has shown that stability in antenna monitor indications generally ensures the stability of directional antenna system operation.

11. However, we are sensitive to the concerns expressed both in this proceeding and earlier in the Docket No. 18471 proceeding that adherence to such a phase tolerance should be the norm, but that short-term variance from such a standard be permissible during unfavorable weather conditions. We agree with the commenters that out-of-tolerance indications during heavy rain, snow or icing, or during abrupt and substantial changes in temperature or humidity, including consequent effects on ground conductivity, may not warrant immediate corrective action. Clearly, to make adjustments to either antenna current amplitude or phase in the absence of appropriate field strength indications may be unwise. Accordingly, we have decided to allow out-of-tolerance operation occuring as a result of adverse climatic conditions for a period of up to 10 consecutive days, provided the monitoring point values specified in the station authorization are within limits. This period is, we think, sufficient for the resolution of most problems of this type. An open-ended period could lead to abuses. Should licensees need to operate out-of-tolerance for more than 10 days, they will be required to notify our AM Branch and request special temporary authority to operate at variance with the rule. Lastly, antenna sample current ratios have an equal potential for being disturbed and we think adoption of a similar policy would be appropriate. Previously, licensees have had to request special temporary authority to operate at variance with the terms of their authorization immediately at the onset of such a situation. We believe this is no longer necessary. Accordingly, § 73.62 is being amended to let the 10 day grace period apply to both antenna monitor ratio and phase indications. The adoption of the 10 day grace period applicable to out-of-tolerance antenna phase and ratio indications should effectively negate any operational or administrative burdens that might be implied by adoption of the new phase tolerance.

12. We do not believe that a 25% tolerance need be applied to monitoring point field strength indications if the $\pm 3°$ antenna phase tolerance is adopted. On December 6, 1979, we adopted, on an

experimental basis, a policy of assigning monitoring point limits using the "direct ratio method."[4] This policy substantially relaxed the monitoring point tolerances from those in effect for many years prior to that time. Our experience with this new policy has confirmed its value in reducing the frequency of adjustments to the antenna patterns of many stations and in reducing the number of readjustment applications filed with the Commission. This has been possible without increasing the interference among stations. Accordingly, rather than adopt the 25% tolerance suggested by NAB, we are herewith adopting permanently the monitoring point policy described in footnote 4.

13. As a final matter, NAB and ABES favor a relaxed phase tolerance if applicants or licensees are able to show that operation would result in no additional interference to other stations. However, such a tolerance (and the showing made to support it) could be rendered meaningless by new or modified cochannel or adjacent channel assignments. Further, such a showing would entail substantial study which, by its very nature, would be more theoretical than practical. Guidelines have long been established concerning phase stability requirements and we see no reason to modify them at this time.

Comments in MM Docket No. 83–16

14. On January 13, 1983, the Commission adopted a *Notice of Proposed Rule Making* (*"83–16 Notice"*) in MM Docket No. 83–16 (48 Fed. Reg. 5978, February 9, 1983) in response to petitions filed by the Association of Federal Communications Consulting Engineers ("AFCCE") and Charles P. Crossno ("Crossno"), a consulting engineer. AFCCE, in RM-3103, sought amendment of the rules to provide for greater flexibility in the use of toroidal current transformers as a means of deriving directional AM station antenna sample currents. It asked the FCC to allow use of these transformers whenever it could be demonstrated that the sampling system operated reliably. Crossno, in RM-3740, requested a change in the rules to permit AM broadcasters to use a remotely controlled switching relay to feed the reference and relative sample currents to the antenna monitor from a central point in the antenna array.

15. In the *83–16 Notice*, the Commission proposed restricting the

[4] This policy was implemented by letter from the Chief, Broadcast Bureau to Donald G. Everist, Chairman of the FCC Processing and Procedure Committee of the Association of Federal Communications Consulting Engineers. The complete text of this letter is given in Appendix B. Under the "direct ratio method," monitoring point limits are obtained by multiplying the measured field strength at a monitoring point by the ratio of the authorized maximum radiation divided by the unattenuated radiation established in the proof-of-performance. This method simply restricts unattenuated radiation to within its maximum authorized value whereas the traditional method, in many cases, restricted radiation more severely.

use of toroidal current transformers to stations with antenna towers of uniform cross-section, or self-supporting towers having a central common feedpoint for all tower legs, where the electrical height of the towers would not exceed 130°. Additionally, we proposed to allow the use of such transformers with "folded unipole" antennas of any height, provided the impedance of the individual tower would not exceed 70 ohms. These limitations were based on the assumed impracticality of using toroidal current transformers on towers greater than 130° in electrical height and out of a desire to avoid the administrative burdens that would have been entailed by the showings proposed by AFCCE.

16. Lastly, we proposed to allow the use of a centrally located relay or other type of switch to provide current samples to the antenna monitor as requested by Crossno. However, we expressed the belief that two related suggestions were unnecessarily burdensome in view of the potential benefit. The two suggestions were that the antenna monitor be capable of being installed at the central switching point with no significant difference in observed ratios or phase indications and that impedance line measurements be made at ±5 kHz of the station's operating frequency at the antenna monitor end of the two sampling lines for each selected element. These latter requirements were not included in the proposed rules.

17. Comments in MM Docket No. 83–16 were filed by AFCCE, Robert A. Jones, P.E. (Jones), Charles I. Gallagher, P.E. (Gallagher) and Taft Broadcasting Company. NAB filed reply comments, and late-filed comments were submitted by Thomas G. Osenkowski on behalf of Radio Station WNYC.

Comments on RM-3103

18. AFCCE and NAB argue for adoption of the original AFCCE proposal (RM-3103) that would allow the use of toroidal current transformers as antenna monitor sample current sources at any AM directional station, provided that a showing of adequate stability could be made. Thus, they are not in favor of the restrictions proposed by the Commission in the *83–16 Notice*.

19. Jones, in his comments, agrees that the toroidal current transformers can be successfully used on guyed towers of uniform cross-section up to 130° in electrical height, but argues that base current sampling is not sufficiently reliable where self-supported or folded unipole types of antennas are used. He also opposes the proposed 30 day test or trial period as a means of demonstrating satisfactory performance of toroidal current transformers in lieu of loops on taller towers.

20. Gallagher expresses the belief that antenna monitor current samples should only be taken from rigid, non-rotatable loops operated at tower potential. He considers any other technique a compromise and cannot see any circumstance where any other

system would result in the sample current being more accurate or reliable than when derived from the tower itself. Amplifying, somewhat, the comments of Jones, Gallagher points out that using the antenna base current as the antenna monitor signal source potentially involves three different types of currents: (1) the actual antenna current (which we will call the "radiated current"), (2) the current to ground which results from the distributed capacity of the base insulator and the lower 10 to 20 feet of tower (which we will call the "distributed base capacity current"), and (3) any current to ground through the tower lighting choke (which we will call the "choke current"). He notes that as long as a tower has a low impedance (as is the case with towers with an electrical height near 90°), the distributed base capacity current will be small and will have little effect on the accuracy of the current sample. However, as a tower (and its impedance) increases, the ratio of the distributed base capacity current to the radiated current will increase and can be significant. He cites two cases where use of toroidal current transformers at stations with taller towers either did or would have resulted in inaccurate sample current ratio indications. On the basis of his experience, Gallagher views the proposed 130° limit as a wise limit on the use of toroidal current transformers.

21. Taft, in its comments, argues that the 130° height limit is inadequate, based on its experience with Station WTVN (Columbus, Ohio). Taft submits extensive measurement data showing accurate and stable current samples derived from toroidal current transformers installed at the base of a tower 141.6° in electrical height. Accordingly, Taft suggests an upper height limit of 150–160° and would prefer to see the terms of the original AFCCE petition adopted (where use with a tower of any height would be permitted if a suitable showing of stability and accuracy was made).

22. Osenkowski discusses at some length his efforts to install untuned sampling loops on two self-supported towers of Station WNYC. He encountered trouble in obtaining sample current signal levels of sufficient amplitude to operate the antenna monitor. After considering various alternatives, he decided to install toroidal current transformers which subsequently provided signals of sufficient amplitude and stability. Osenkowski notes that while uniform, guyed antenna towers generally have sinusoidally distributed current, self-supported, diamond and other assorted types of towers are assumed to be markedly non-sinusoidal in terms of current distribution. Any number of factors, he indicates, can result in nonsinusoidal current distribution, making the point of current maxima difficult to determine and subject to change. In such cases, loop placement can be difficult to determine and use of toroidal current transformers can often be beneficial. Osenkowski notes that while a toroidal current transformer signal sample may not reflect a condition of snow or ice, it should be remembered that such a condition will

strate the suitability of toroidal current transformers in antenna systems with towers more than 130° in electrical height will be required.[7] The showing must reflect that over a consecutive 30 day period, all antenna monitor indications were within tolerance. Data shall be taken daily or weekly for each antenna pattern pursuant to the new provisions set forth in § 73.68(a)(4)(ii).

29. The comments submitted in response to the *83–16 Notice* supported our proposal to allow the use of radio frequency relays to switch sampling current signals from different antenna towers and feed them to the antennas monitor by way of only two sampling lines (one carrying the "reference" signal and the other the "relative" signal). Accordingly, we are adopting the rules proposed therein.[8] However, we have anticipated that in lieu of a switch or relay, a licensee may wish to install the antenna monitor at the central point in the array and remotely read its various meter indications. This is already permitted if an antenna phasor unit is located in the center of the antenna field. (See Section 73.69(a)(1)). However, we have no objection to installation of the antenna monitor in a structure other than a phasor house, provided the antenna monitor can operate accurately over the wide temperature and humidity extremes that are typical of antenna tuning houses. In this regard, we expect that a similar type of structure would serve as a junction point for the antenna sample current lines and as a housing for the radio frequency relay or motor-driven switch. However, in the case of extreme temperature or humidity changes, the licensee would have to install such equipment as may be necessary to keep the environment in the housing structure within the specified operating parameters for the particular antenna monitor. Thus, while we are amending the rules as requested, we urge licensees to give careful consideration to cost-benefit tradeoffs associated with centralized installation of a radio frequency relay or switch, or even the antenna monitor itself, since operating and maintenance costs of the additional structure, as well as potential inconvenience in visiting it for maintenance purposes, may eventually surpass the cost of running antenna sample current coaxial cable from each tower directly to the transmitter building.

Conclusion

30. The *78–28 Notice* was issued prior to the adoption of the Regulatory Flexibility Act of 1980 (P.L. 96–354) and is therefore exempt from its provisions. Nevertheless, we recognize that a small number of directional AM station licensees may be adversely affected by our adoption of the ±3° phase tolerance in that they may

[7] We would note that of 1840 directional operations, only 250 have towers more than 130° in electrical height.

[8] See the *83–16 Notice*, Paragraph 21.

be compelled to upgrade substandard antenna monitoring systems where the monitoring system, rather than the actual antenna system, is responsible for out-of-tolerance indications. According to our estimates, there are approximately 650 directional AM stations (most of which would probably be classified as "small business entities" under the provisions of the Regulatory Flexibility Act) that have not installed FCC-approved antenna monitoring systems. Of this number, some undoubtedly have sampling systems that are adequate, even if not FCC-approved. Accordingly, the number of directional AM station licensees that potentially would be adversely affected by our adoption of the ±3° phase tolerance is small.

31. With respect to the Docket No. 83–16 proceeding, we pointed out in the *Notice* (Paragraph 30) that the provisions of the Regulatory Flexibility Act did not apply since the rules proposed were completely optional in nature and would not compel licensees to acquire any new equipment, undertake new record-keeping requirements or modify existing practice in any way. This contention was not disputed in the comments, so no additional Regulatory Flexibility Act analysis is herein being provided.

32. Accordingly, IT IS ORDERED, pursuant to the authority contained in §§ 4(i) and 303 of the Communications Act of 1934, as amended, that Part 73 of the Commission's Rules ARE AMENDED, effective January 1, 1984, as set forth in the attached Appendix. IT IS FURTHER ORDERED that this proceeding IS TERMINATED.

33. IT IS FURTHER ORDERED that the Secretary shall cause this *Report and Order* and its appendices to be published in the FCC Reports.

34. Further information on this matter may be obtained by contacting James E. McNally, Jr., Mass Media Bureau, (202) 632–9660.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX A

I. 47 C.F.R. Part 73 is amended as follows:

1. Section 73.62 is revised as follows:

§73.62 Directional antenna system tolerances.

Each AM station operating a directional antenna must maintain the indicated relative amplitudes of the antenna base currents and antenna monitor currents within 5% of the values specified on the instrument of authorization, unless other tolerances are specified therein. Directional antenna relative phase currents must be maintained to within ±3° of the values specified on the instrument of authorization, unless other tolerances are specified therein; provided that during periods of inclement weather or severe climatic conditions, a licensee may operate at variance with these provisions for a period up to 10 consecutive days, providing the monitoring point values specified in the station authorization are within limits. If, at the end of this 10 day period normal operation is not restored, the licensee must request from the

FCC in Washington, D.C., special temporary authority to operate the station at variance with the provisions of this section.

2. Section 73.68 is revised as follows:

§73.68 Sampling systems for antenna monitors.

(a) * * *

(1) All coaxial cable from the sampling elements to the antenna monitor, including cable used in the construction of isolation coils, except short lengths of flexible cable connecting the transmitter house sampling line termination to the monitor, must have a solid outer conductor and have uniform physical and electrical characteristics. The dielectric must be either predominantly pressurized air or other inert gas, or foamed polyethylene.

(i) All sampling lines for a critical antenna array (i.e., an array for which the station authorization requires the maintenance of phase and current relationships within specified tolerances) must be of the same electrical length, with corresponding lengths of all lines exposed to equivalent environmental conditions.

(ii) For other arrays, lines of differing length may be employed, provided that the difference in length between the longest and the shortest line is not so great that, over the range of temperatures to which the system is exposed, predicted errors in indicated phase difference resulting from such temperature changes will exceed 0.5°.

(iii) A sampling line mounted on a tower must be adequately supported to prevent displacement, and must be protected against physical damage. Where feasible, sampling line sections between each tower base and the transmitter house is to be jacketed and buried: lines run above ground must be firmly supported, and protected against physical damage, with the outer conductor strapped to the station's ground system at such points as found necessary to minimize currents induced by antenna radiation.

(iv) All necessary connections and outdoor cable terminations must be made with waterproof fittings designed for use with the type of cable employed.

(v) For determining the permissible differences in line lengths that may be installed, the total difference between the highest listed normal daily maximum and lowest listed normal daily minimum temperatures as shown for the nearest location shown in the most recent issue of "Local Climatological Data Annual Summaries" shall be used in the calculations. This publication is available from:

National Climatic Center
National Oceanic and Atmospheric Administration
Asheville, North Carolina 28801

(vi) The provisions of this subparagraph do not preclude the use of a centrally located impedance-matched radio frequency relay or remotely controlled switch to provide relative sampling currents to the antenna monitor over a single transmission line. However, the reference sampling line and the relative sampling line from the switching point to the antenna monitor must be identical in type and electrical length, and must be exposed to the same environment. The sampling line from each sampling element to the relay must conform to all relevant requirements indicated in this subparagraph. Alternatively, a licensee may install the antenna monitor at a centrally located or otherwise convenient location provided that the temperature and humidity of the operating environment are maintained within the tolerances specified by the antenna monitor manufacturer. When such an antenna monitor is to be remotely controlled and read, installation shall conform to the requirements of §73.67 of this Part.

(2) Except as provided below, sampling elements must be single turn, unshielded

loops of extremely rigid construction, with ample, firmly positioned gaps at the open loop end, mounted on towers at a fixed orientation. Loops must be installed to operate at tower potential, provided that for towers less than 130° in electrical height, loops operating at ground potential may be used. Each loop must be mounted on the tower near the point of maximum tower current, but in no case less than 3 meters (10 feet) above ground.

(3) Shielded current transformers may be used in lieu of unshielded loops to extract samples from antenna feed lines at the base of each tower having a uniform cross-section and 110° or less in electrical height, or a self-supporting tower 110° or less in electrical height, provided it has a common feedpoint for all tower legs.

(4) Shielded current transformers may be used in lieu of unshielded loops to extract samples from the antenna feed line at the base of each tower having a uniform cross-section more than 110° but not greater than 130° in electrical height, self-supporting towers not exceeding 130° in electrical height and having a central common feedpoint for all tower legs, and folded unipole antennas of any height having a base driving point resistance and reactance not exceeding 70 ohms, provided the following conditions are met:

(i) Stability of operation during a test period of 30 continuous days using the current transformers must demonstrate that the antenna monitor sample current ratios do not exceed 5% of those specified on the station authorization and that the relative phase indications are within ±3° of the values specified on the station authorization, unless a more stringent tolerance is specified therein.

(ii) The following parameters shall be read and recorded as indicated during the 30 day test period for each antenna pattern:

(A) Indications at each monitoring point specified in the station authorization, weekly.

(B) Base currents and their calculated ratios, weekly.

(C) Common point current, daily.

(D) Antenna monitor sample current amplitudes and their ratios, daily.

(E) Antenna monitor phase indications, daily.

(iii) Failure to meet the stability requirement specified in (i) above will require that the licensee seek special temporary authority to operate at variance with the terms of the station instrument of authorization until the problem can be corrected.

(iv) A certification by the licensee that the sampling system meets the stability requirement specified in this paragraph must be included in the request for approval of the monitor sampling system together with the information specified in paragraph (c) below.

(v) Shielded current transformers may be used in lieu of unshielded loops to extract samples from the antenna feed line at the base of each tower greater than 130° in electrical height provided the requirements set forth in subparagraphs (4)(i) through (iii) above are satisfied and the resulting data is included in the request for approval of the monitor sampling system together with the information specified in paragraph (c) below.

(vi) The FCC may request the licensee to conduct such other tests, or measurements, or submit additional data it deems necessary to determine the stability of the antenna sampling system.

* * * * *

APPENDIX B

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554
December 6, 1979

IN REPLY REFER TO:
8800-DW

Mr. Donald G. Everist, Chairman
FCC Processing and Procedure Committee
Association of Federal Communications
Consulting Engineers
1015 - 15th Street, N.W., Suite 703
Washington, D.C. 20005

Dear Mr. Everist:

I have your letter of October 22nd, written on behalf of your committee, requesting modification of certain Commission engineering practices used in assigning monitoring point limits to AM directional broadcast stations. Your letter formalizes suggestions developed in a series of meetings, begun well over a year ago, between your committee and members of the Broadcast Facilities Division's engineering staff concerning the policies and procedures governing the preparation and processing of various types of applications. The interest shown throughout this period by your committee in helping improve our processing procedures has been helpful and is greatly appreciated.

Specifically, your committee feels that, under the present policy, monitoring point limits are often assigned which are unnecessarily restrictive and urges the adoption of a policy whereby the assignment of these limits is based on the "direct ratio" method. The committee also urges the establishment of a policy whereby stations subject to seasonal conductivity changes can achieve relaxed limits upon submission of "seasonal proofs." Additionally, the committee requests that the Commission refrain from altering monitoring point limits based on partial proofs of performance if "substantial conformance" of the radiation patterns is demonstrated and the antenna parameters are either essentially unchanged or, if changed, adequately justified.

In response to your first suggestion, I am pleased to announce that we have, on an experimental basis, adopted the policy of assigning monitoring point limits using the direct ratio method. Under the direct ratio method, monitoring point limits are obtained by multiplying the measured field strength at a monitoring point by the ratio of the authorized maximum radiation divided by the unattenuated radiation established in the proof of performance. This method simply restricts unattenuated radiation to within its maximum authorized value whereas the traditional method, in many cases, restricted radiation much more severely. Theoretically, objectionable interference is not caused if antenna radiation is maintained below its maximum authorized value. Assuming, therefore, that changes in monitoring point field strength correspond directly to changes in antenna radiation, monitoring point limits determined by the direct ratio method should be adequate to avoid interference. However, since the assumption of a linear relationship between monitor point readings and antenna radiation becomes somewhat questionable with excessive changes, we do not intend to assign limits higher than 200% above proof values. In addition, because operation with monitoring point field strength in excess of the direct ratio limit could result in objectionable interference, we will continue to deny requests to exceed those limits.

Your second suggestion addresses a problem encountered in many areas of the country where complete proofs of performance are done during the summer months when ground conductivity is significantly lower than during the winter months. Often

monitoring point limits resulting from such summertime proofs are not sufficient to accommodate higher readings encountered during winter. In such a case increased limits are obtained by collecting supplemental wintertime data in the form of a partial proof of performance consisting of at least 10 measurements on each radial established in the complete proof (see Section 73.154(a) of the Rules). You suggest that the Commission accept "seasonal proofs" for this purpose in lieu of partial proofs. A seasonal proof would consist of "at least 20 field strength measurements, both nondirectional and directional, on each of the radials specified in the construction permit and at least one radial in the major lobe."

In responding to this suggestion, it is helpful to understand the approach used by Commission engineers in analyzing complete proofs of performance. These generally consist of 20 or 30 measurements per radial (see Section 73.186(a)(1)) and serve as the reference for all subsequent partial proofs. As you know, the fundamental problem is distinguishing between the effects of conductivity and antenna radiation. In making this distinction, we consider it imperative to establish, as conclusively as possible, the size and shape of the nondirectional radiation pattern. The nondirectional radiating system is simpler (fewer variables) than the directional system and its RMS (size) can be more accurately determined since each measured radial is of more or less equal significance, particularly if the radials are evenly spaced. With a directional pattern, many of the minor-lobe and null radials do not contribute significantly toward defining the RMS, leaving the remaining main lobe radials with a disproportionate influence on the determination of the pattern size. For these same reasons, the Commission relies entirely on nondirectional measurement data in determining the extent of seasonal changes in conductivity.

Because of the crucial role played by the nondirectional pattern resulting from a complete proof of performance, extreme care is used in analyzing the measurement data. Experienced engineers who have been carefully trained are used in this work. All known external factors such as terrain features, reradiating structures, pipe lines, etc., are taken into account. Each radial is repeatedly weighed against the others with constant attention to the resulting pattern shape and RMS and the analysis is not considered complete until the importance of each element of data is understood from the perspective of the whole. Of course, the more extensive and "well behaved" the measurement data, the more precise and confident the engineer can be with his/her analysis. Once the nondirectional pattern is established, analysis of the directional data can usually be done mathematically, rather than graphically, using either arithmetic or logarithmic averages. Any subsequent nondirectional partial proofs which are submitted to the Commission for the purpose of documenting suspected conductivity changes are mathematically analyzed, point for point along each radial, against the complete proof nondirectional data (see Section 73.186(a)(5)). If the possibilities of distortion and changed RMS can be eliminated from the partial proof nondirectional pattern, then the extent of conductivity change along each radial can be determined and applied to the directional partial proof data revealing whether, in fact, observed changes in directional field strengths resulted from changes in the radiation pattern or simply from conductivity changes.

The notion of a seasonal proof, to the extent that some of the proof radials would be eliminated, strikes at the very heart of our approach which is an accurate determination of the nondirectional radiation pattern. Although, under the committee's suggestion, the minimum number of measurements on some radials would be raised from 10 to 20, we do not feel the value gained from additional data on these radials would be sufficient to offset the complete loss of data on the remaining radials. This is also the case for directional patterns where changes in radiation in some directions can affect radiation in other directions and assumptions of pattern symmetry are generally unreliable. The Commission encourages supplemental measurements in addition to the minimum of 10 per radial required by the Rules; this should not be accomplished, however, at the expense of fewer measurements on other radials.

Your last suggestion concerns the Commission's assignment of monitoring point limits in response to partial proofs of performance conducted following antenna repairs, refurbishment, construction or readjustment. Often such proofs result in a reduction in limits below those previously assigned because measurements were taken during periods of low conductivity or because antenna radiation in some directions was reduced. The committee suggests we not lower limits in such cases if the pattern remains in substantial conformance and the antenna parameters (phases and current ratios) are either essentially unchanged or, if changed, adequately justified. We believe this suggestion has merit and have, also on an experimental basis, ceased the practice of lowering limits based on partial proofs except when such limits would exceed measured values by more than 200%.

We feel that the current mandatory use of type-approved antenna monitors by directional stations and the widespread use of approved sample systems permit these changes in policy at this time without endangering in any way the technical integrity of our AM broadcasting system. Nonetheless, because of the significance of these changes, we intend to proceed on an experimental basis for at least a year, gaining the benefit of practical experience, before permanently adopting them. In addition, cases clearly falling beyond the scope of these policies will continue to be handled on a case-by-case basis.

We are hopeful that the changes we have initiated in response to your suggestions will provide many stations with operating tolerances sufficient to accommodate variations which, under our old policy, would have required a proof of performance and the filing of an application with the Commission. Again, I would like to express my sincere appreciation for the work done by your committee in bringing forth these suggestions.

Sincerely,

Richard J. Shiben
Chief, Broadcast Bureau

Call Letters, Assignment Rules, Amendment of

Report and Order adopted revising Section 73.3550 of rules with respect to assignment of call letters to b/c stations. Action taken to eliminate unnecessary regulations and policies and to provide efficient and expeditious service to the public.
–Amendment of Part 73
MM Docket No. 83-373

FCC 83–573

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Matter of Revision of Section 73.3550 of the Commission's Rules with respect to the Assignment of New and Modified Call Letters to AM, FM and TV Broadcast Stations	MM Docket No. 83–373

REPORT AND ORDER
(PROCEEDING TERMINATED)

(Adopted: December 1, 1983 Released: December 14, 1983)

BY THE COMMISSION: CHAIRMAN FOWLER CONCURRING IN THE RESULT; COMMISSIONER QUELLO DISSENTING IN PART AND ISSUING A STATEMENT.

1. The Commission has before it the *Notice of Proposed Rulemaking* in this proceeding (48 Fed. Reg. 20252, published May 5, 1983). In the *Notice*, we proposed significant revisions of processing procedures as well as our underlying policies with respect to the assignment of call letters to broadcast stations.

2. The present call letter rules are the result of our 1973 action codifying existing Commission policies which were scattered throughout various decisions and public notices and, at the same time, addressing processing problems not previously considered. *Assignment of Call Signs*, 41 FCC 2d 481 (1973). In essence, that proceeding provided that a station may, in most situations, request call letters of its choice (except the initial letter) if the desired call letters are available, are in good taste, and are sufficiently dissimilar phonetically and rhythmically from existing call letters of stations in the same service area so that there will be no significant likelihood of public confusion. That proceeding also dealt with such

matters as the actual procedure for requesting call letters and the filing of an objection to a proposed set of call letters, requests by a proposed assignee, reassignment of relinquished call letters and conforming basic call letters. In the *Notice*, we indicated that after nearly ten years of experience, the present rules warrant revision or, at the very least, detailed review to determine whether these rules should be retained, modified or eliminated. Included in the *Notice* were proposals to clarify the criteria to be used in resolving a call letter dispute, eliminate the requirement for actual notifications to all broadcast stations within 35 miles, shorten or eliminate the 30-day holding period, and eliminate proscriptions concerning conforming call letters and reassignment of call letters in the same community. This *Notice* also contained a controversial proposal to have call letter objections considered in local forums.

CALL LETTER DISPUTES IN LOCAL FORUMS

3. All of the comments we received in this proceeding opposed our proposal to have call letter disputes resolved in local forums. The gravamen of these oppositions is that litigation in a local forum premised on unfair competition would be complicated, costly and time-consuming. The local judicial process involves pleadings, hearings, temporary restraining orders, and damages. These comments also referred to the possibility of inconsistent results and the fact that several courts could have jurisdiction in a particular case. In addition, these comments observed that under this proposal, confusing call letters could actually be in use in a particular community before the local forum acts. This would be harmful to the public and unfair to the broadcaster. Furthermore, the broadcaster would no longer be able to receive a final approval before it makes substantial efforts to promote its new call letters. Finally, several comments have asserted that this proposal would contravene Section 303(o) of the Communications Act which requires the Commission to retain "full and unhampered" authority over call letter matters.

4. After careful consideration of these comments, we continue to believe that our adjudication of these disputes represents an unnecessary and inefficient use of our administrative resources. Therefore, we will no longer be the forum to resolve a call letter dispute. First of all, it should be emphasized that none of the comments disputed our contention that an adequate remedy does, in fact, exist in local forums. Rather, these comments have asserted that resolution in local forums would impose additional costs and delays upon broadcasters. While these comments have not documented these expenses and burdens, they have referred to a potential cycle of hearings, pleadings, temporary orders as well as damages and the appeal process. In considering these comments, it is quite possible that in some jurisdictions, the costs, burdens and delays would be greater than those attendant to our processes.

However, it should be emphasized that our present procedures are not without burdens and delays for the broadcaster. Our procedures involve notifications, objections, staff decisions, reconsideration of staff decisions, requests for stay, applications for review of the staff decision to the Commission, reconsideration of the Commission decision and judicial appeal. As a consequence, we are not persuaded that comparing the relative burdens and delays of the local forum *vis-a-vis* our procedures should be determinative of this matter. In this connection, it should also be noted that our present procedures resulted from an early concern with protecting stations from other stations using confusingly similar call letters. Today, broadcasting is a mature and healthily competitive industry with significantly less need for any protectionist policies. See *Classical Broadcasting Society of San Antonio, Inc.*, 53 RR 2d 87 (1983). The broadcasting industry is well able to pursue its remedies and assert its rights in the various local forums in the same manner as other industries.[1] This can be done without imposing the present burden on our administrative resources.

5. In *Classical Broadcasting Society of San Antonio, Inc.*, *supra*, we stated that many of our decisions exalted form over substance in determining whether there would be a significant likelihood of public confusion. We feel that an analogy can be made to our present procedures. In this regard, Section 73.1201 of the Rules only requires that a station announce its call letters once an hour. At all other times, a station may identify or promote its station as it sees fit. The promotional identifications (e.g., Q107, DC101) may have little, if any, relationship to the actual call letters. Furthermore, the promotional announcement may, as far as the public is concerned, be the means of identifying a station. Our present procedures do not take this into account or the fact a requested set of call letters could be easily confused with an existing promotional identification (e.g., KIKR with "Kicker Radio"). Our existing policy is to defer such a controversy to a local forum. See *Shamrock Development Corp.*, 32 FCC 2d 82 (1971). This policy has not visited any apparent burden or hardship upon broadcasters, or resulted in public confusion. As a consequence, it makes little sense for us to continue to be a forum to resolve a dispute limited solely to call letters when these call letters, compared to the actual means of identifying a particular station, may have little relevance to the issue of public confusion. The local forum would take all relevant factors into consideration and, thus, would be the most accurate forum to resolve the issue of public confusion.

6. In a similar vein, we do not feel that the other arguments

[1] In order to facilitate a resolution in the local forum, it is our view that a licensee possesses a sufficient interest in its call letters during the term of its license to pursue, without our objection, a service mark under Sections 2 and 3 of the Trademark Act (15 U.S.C. §§1052 and 1053).

advanced against this proposal would warrant the opposite result. It is probable that in most disputes, several courts could have jurisdiction over a particular dispute. However, such questions of jurisdiction, venue and conflict of laws are common to many other types of disputes and would not appear to present any unusual problems for broadcasters. We also do not feel that there is any significant problem with respect to the possibility of inconsistent decisions throughout the various jurisdictions. Each dispute involves unique sets of call letters, involving one or more of three broadcast services in various communities throughout the United States. Moreover, we believe that a local forum would also be more attuned to what constitutes a potential for public confusion in its local community. The comments have also observed that the procedure outlined in the *Notice* could result in confusing call letters actually being in use while the issue is litigated in local court. In practice, we do not think this would be a pervasive problem. First of all, in the absence of prior Commission approval, a broadcaster would be extremely reluctant to select and use confusingly similar call letters since it may have to respond ultimately in damages to the aggrieved broadcaster and incur the additional expense of selecting new call letters. In any event, as stated in the *Notice*, less than 10% of the objections to requested call letters are sustained. Inasmuch as approximately 10% of all call letter request receive an objection, the potential for this type of confusion appears to be *de minimis*. Finally, Section 303 of the Communications Act does not require the Commission to continue to resolve call letter disputes between broadcasters. This Section merely grants the Commission authority to "designate call letters to all stations." It does not restrict our authority to implement this section or determine the most appropriate forum to resolve call letter disputes.

NOTIFICATION AND 30-DAY HOLDING PERIOD

7. As indicated in the preceeding paragraphs, the Commission will no longer be the forum to resolve call letter disputes. Consequently, the notification requirement and a 30-day holding period are no longer necessary and Section 73.3550(e)(1) and 73.3550(g) of the Rules will, therefore, be eliminated.

CONFORMING BASIC CALL LETTERS

8. In the *Notice* we proposed modification of Section 73.3550(1) of the Rules which presently permits conforming the basic call letters of commonly owned stations assigned to the "same or adjoining" communities. While most of the comments were favorable, Arbitron Ratings Company filed comments opposing this proposal. Arbitron's concern appears to focus on public confusion in identifying a particular station if we were to permit commonly owned stations in the same service to use the same basic call sign. This concern is not

well founded. As proposed, this rule will not permit two commonly owned stations in the same service (e.g., FM) to have the same basic call sign. Instead, this modification merely permits a licensee of an AM, FM and/or television station to use the same basic call sign (with required "-FM" and "-TV" suffixes) regardless of the location of the stations. Accordingly, for the reasons outlined in paragraph 11 of the *Notice,* we are eliminating the requirement that the stations be assigned to the same or adjoining communities.

REASSIGNMENT OF RELINQUISHED CALL LETTERS

9. The comments we received concerning our proposal to have relinquished call letters assigned on a "first-come-first-served" basis were favorable. Presently, Section 73.3550(k) of the Rules provides for the Commission to announce the availability of relinquished call letters. All requests received within a subsequent 15-day period are considered on an equal footing, with the call letters being awarded to the applicant having the longest continuous record of broadcast service. The purpose of this provision was to avoid the purported problem of trafficking in call letters. Specifically, trafficking involves a licensee relinquishing call letters and another licensee wishing to acquire them, by prearrangement, controlling the "availability" date by the appropriate timing of their respective requests. We previously viewed this practice as being unfair to other parties having a legitimate interest in the relinquished call letters and bordering on an abuse of process. Upon reflection, we do not believe that such private agreements between licensees harms the public interest to the extent of justifying the ongoing administrative burden this rule places upon our processing staff. Therefore, we are eliminating the 15-day procedure and will process all call letter requests on a "first-come-first-served" basis. In the event we receive requests for the same call letters on the same day, we would only then select the applicant with the longest continuous period of broadcast service.

10. On the other hand, we did receive comments in opposition to our proposal to eliminate Section 73.3550(q) of the Rules, which proscribes reassignment of call letters in the same community within 180 days except to the same licensee or its successor-in-interest. The purpose of the rule is to avoid the erroneous impression among listeners and viewers that the same principals are involved in the new operation. We remain skeptical whether this rule furthers a tangible public interest objective. The opposition comments have focused upon possible distortions in audience ratings. These comments assert that the public often associates a station's call letters with the station well after a station changes its call letters. In the event another station commences using the relinquished call letters, the public would be confused as to what station they are actually listening, and distortions in audience ratings would result. This

argument is speculative and our experience in somewhat similar circumstances have not resulted in instances of public confusion. In this connection, the rule, as presently written, permits a station in an adjoining or nearby community to immediately acquire the relinquished call letters. This rule also permits a licensee who is disposing of one facility and acquiring another facility in the same community to transfer its call letters to the new facility. We are unaware of instances of resulting public confusion. By the same token, there does not appear to be public confusion or audience ratings distortion when an AM/FM combination, with the same basic call letters, changes the call letters of one station. In these situations, the absence of public confusion may result from the efforts of the station to promote its new call letters and the fact the public may very well be more discerning in its ability to identify a station than is often perceived.[2] In any event, as indicated earlier, we are unconvinced that the purported problem justifies retaining the rule and Section 73.3550(q) of the Rules will be eliminated.

"SUITABLE CLEARANCE" AND "GOOD TASTE"

11. We did not receive any opposition to our proposal to eliminate Section 73.3550(s) of the Rules, which proscribes the assignment of call letters using the initials of the President, a living former President, the United States of America or any of its agencies or departments, unless "suitable clearance" is obtained. We continue to believe that the public interest is not served by a rule which requires the applicant to undertake a burdensome effort to obtain "suitable clearance" and requires the Commission to determine whether these efforts are, in fact, sufficient. If a station attempts to use such call letters in a manner intended to suggest a relationship with a President or a federal agency, there are adequate remedies outside the context of call letter processing. Therefore, Section 73.3550(s) will also be eliminated.

12. We are eliminating the "good taste" language presently set forth in Section 73.3550(j) of the Rules. We agree with both the National Radio Broadcasters Association and the National Association of Broadcasters that the Commission should not be an arbiter in this area. Good taste is a concept for which standards have traditionally been set and enforced by the local communities. We will therefore rely upon the broadcasters' responsiveness to, among

[2] We must concede that the absence of public confusion in these situations may stem, in part, from the fact that we do not require a station to commence use of new call letters during a rating period or even during the time shortly before a rating period. Therefore, there would be a hiatus between the time a station commences use of the new call letters and the time a station is identified during the next rating period.

other things, their communities' wishes and federal law dealing with the broadcast of obscene indecent and profane material[3] to control the selection and use of call letters.

13. Pursuant to the Regulatory Flexibility Act of 1980, the Commission's final analysis is as follows:

I. *Need for and Purpose of the Rules*

1. We have concluded that requiring applicants to notify all broadcast stations within 35 miles and comply with other rules and procedures of questionable public interest value unnecessarily burdens the applicant and delays the processing of these requests.

II. *Summary of issues raised by public comments in response to the initial regulatory flexibility analysis, Commission assessment, and changes made as a result*

A. *Issues Raised*

1. There were comments asserting that extra costs attendant to litigating a call letter dispute in a local forum would be an undue burden on broadcasters.

2. There were also comments that the Commission did not consider the alternative of retaining jurisdiction over such disputes.

B. *Assessment*

1. We have carefully considered these comments in order to determine if there will be a significant financial and administrative impact on a substantial number of small businesses. The comments did not detail or document the relative costs of pursuing a remedy in a local forum *vis-a-vis* the Commission. In this regard, it should be noted that as outlined in paragraph 4, *supra*, the Commission procedures can entail significant costs and delays for the broadcaster. Nevertheless, in some jurisdictions, the costs and delays of pursuing a remedy in the local forum could very well be greater. However, with respect to these situations, it should be reiterated that broadcasting is a mature and financially viable industry able to pursue its remedies in local forums.

III. *Significant Alternatives Considered and Rejected*

1. The alternative rejected was to remain the forum to resolve call letter disputes. In addition to the fact that we consider this to be an unnecessary and inefficient use of our administrative resources, we feel that the local forum will provide the most complete forum for relief. As discussed in paragraph 5, *supra*, call letters may or may not be the primary means by which a station is identified or preceived in a particular community. Inasmuch as we do not consider promotional acronyms in resolving call letter disputes, our resolution is limited and may not, in actuality, reflect the correct result with respect to the issue of public confusion in a particular community. Local forums could take

[3] 18 U.S.C. §1464 (1976); *See F.C.C.* v. *Pacifica Foundation*, 438 U.S. 726 (1978).

these other uses into consideration and, thus, be the most effective forums in making such determinations.

12. Authority for adoption of the rules contained herein is contained in Sections 4(i) and 303 of the Communications Act of 1934, as amended.

13. Accordingly, IT IS ORDERED, That Section 73.3550 of the Commission's Rules IS AMENDED as set forth in Appendix A, effective January 20, 1984.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX A

Section 73.3550 of the Commission's Rules is amended to read as follows:

§73.3550 Requests for new or modified call sign assignments.

(a) Requests for new or modified call sign assignments for broadcast stations shall be made by letter to the Secretary, FCC, Washington, D.C. 20554. An original and one copy of the letter shall be submitted and shall be accompanied by the filing fee, if required, specified in §1.1111. Incomplete or otherwise defective filings will be returned by the FCC, and any filing fee submitted in connection therewith will be forfeited 45 days from the date the application is returned should the applicant fail to submit an acceptable call sign application for the same station within that period. As many as five call sign choices, listed in descending order of preference, may be included in a single request. A call sign may not be reserved.

(b) No request for a new call sign assignment will be accepted from an applicant for a new station until the FCC has granted a construction permit. Failure by the permittee of a new station to request the assignment of a specific call sign within 30 days of grant of the construction permit will result in the FCC, on its own motion, assigning an appropriate call sign.

(c) An applicant for transfer or assignment of an outstanding construction permit or license may, in accordance with this Section, request a new call sign assignment at the time the application for transfer or assignment is filed, or at any time thereafter. In the absence of written consent of the proposed transferor or assignor, no change in call sign assignment will be made effective until such application is granted by the FCC and the transaction consummated.

(d) Where an application is granted by the FCC for transfer or assignment of the construction permit or license of a station whose existing call sign conforms to that of a commonly owned station not part of the transaction, the assignee shall, within 30 days after consummation, request a different call sign in accordance with the provisions of this Section. Should a suitable application not be received within that period of time, the FCC will, on its own motion, select an appropriate call sign and effect the change in call sign assignment.

(e) Call signs beginning with the letter "K" will not be assigned to stations located east of the Mississippi River, nor will call signs beginning with the letter "W" be assigned to stations located west of the Mississippi River.

(f) Only four-letter call signs (plus FM or TV suffixes, if used) will be assigned. However, subject to the other provisions of this Section, a call sign of a station may be conformed to a commonly owned station holding a three-letter call sign assignment (plus FM or TV suffixes, if used).

(g) Subject to the foregoing limitations, applicants may request call signs of their choice if the combination is available. Objections to the assignment of requested call signs will not be entertained at the FCC. However, this does not hamper any party from asserting such rights as it may have under private law in some other forum. Should it be determined by an appropriate forum that a station should not utilize a particular call sign, the initial assignment of a call sign will not serve as a bar to the making of a different assignment.

(h) Call signs are assigned on a "first-come-first-served" basis. Receipt by the FCC of a request for an available call sign blocks the acceptance of competing requests until the first received request is processed to completion. In the case of requests for the same call sign being received on the same date at the FCC, the assignment (if otherwise grantable) will be made to the station having the longest continuous record of broadcasting operation under substantially unchanged ownership and control. However, involuntary and *pro forma* assignments and transfers will not be taken into account in determining priority.

(i) Stations in different broadcast services which are under common control may request that their call signs be conformed by the assignment of the same basic call sign. For the purposes of this paragraph, 50% or greater common ownership shall constitute a *prima facie* showing of common control.

(j) The provisions of this Section shall not apply to International broadcast stations, to stations authorized under Part 74 of the Rules, nor to FM or TV stations seeking to modify an existing call sign only to the extent of adding or deleting an "-FM" or "-TV" suffix. The latter additions and deletions may be effective upon notification to the Commission.

(k) Unless subject to a pending transfer or assignment application, a change in call sign assignment will be made effective on the date specified in the telegram authorizing the change. In this regard, the applicant may include with its application a request for a specific effective date to take place within 45 days of the submission of its application for a call sign. Postponement of the effective date will be granted only in response to a timely request and for only the most compelling reasons.

(l) Four-letter combinations commencing with "W" or "K" which are assigned as call signs to ships or to other radio services are not available for assignment to broadcast stations, with or without the "-FM" or "-TV" suffix.

(m) Users of nonlicensed, low-power devices operating under Part 15 of the FCC rules may use whatever identification is currently desired, so long as propriety is observed and no confusion results with a station for which the FCC issues a license.

December 1, 1983

STATEMENT OF FCC COMMISSIONER JAMES H. QUELLO DISSENTING IN PART

In re: Report and Order revising Section 73.3550 of the Commission's Rules with respect to the assignment of call letters to broadcast stations.

The Commission should continue its policy of routinely reviewing call letter requests in order to ensure that the government does not issue a call sign that is either offensive to listeners or viewers or abusive toward any segment of the audience. The Commission has

the responsibility under the Communications Act to designate call signs "as public convenience, interest, or necessity requires,"[1] and the Commission requires regular and frequent broadcast of this identifying symbol.[2] In my view, the Commission's clear and unavoidably affirmative role in the selection and broadcast of call signs mandates a determination by the Commission that every assignment of call letters will serve the public interest.

The majority opinion notes that the criminal law prohibition on broadcast of obscene, indecent, or profane language[3] would apply to the selection of call signs, but this strict criminal standard is not appropriate for determining whether a symbol is suitable for government issue. For example, there is no indication under existing law that ethnic slurs would be covered by the statutory prohibition, but I think it is evident that the use of such a word in the official identification of a broadcast licensee would be improper.

The majority's decision does not address how a request for an objectionable call sign would be processed nor what the Commission's role would be should a call sign be challenged as violating the criminal law. I am not sure whether in such a case we Commissioners should be the judges or the licensee's co-defendants. We certainly shall not be disinterested spectators to the proceeding because only the Commission can order the effective relief of changing the offending call sign.

I believe my colleagues have improperly ignored this Commission's controlling role regarding call sign selection and broadcast, and thus they have misplaced their well-intentioned concerns about free speech for licensees. This is an unnecessary agency action, and I only hope that it will not damage the Commission's ability to eliminate the real restrictions which still limit licensees' editorial freedom.

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[1] 47 U.S.C. §303 (1976).
[2] 47 U.S.C. §303(p) (1976); 47 C.F.R. §73.1201 (1983).
[3] 18 U.S.C. §1464 (1976).

Refund
Remand From Court of Appeals
Television Program Transmission Services

Order adopted explaining proper calculation of refunds due certain subscribers of television transmission service connecting Los Angeles to several Western states. Order responds to remand by U.S. Court of Appeal for D.C. Circuit.
–American Television Relay, Inc.

FCC 83–548

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of

AMERICAN TELEVISION RELAY, INC.

Refunds resulting from the findings and conclusions in Docket No. 19609

MEMORANDUM OPINION AND ORDER

(Adopted November 23, 1983; Released December 12, 1983)

BY THE COMMISSION:

1. This matter was remanded to the Commission for the limited purpose of further explaining the proper calculation of refunds due the customers of American Television Relay, Inc. (ATR). *Las Cruces TV Cable v. FCC*, 645 F.2d 1041 (D.C. Cir. 1981). The refunds were occasioned by the Commission's findings in Docket No. 19609 that ATR's rates for the period 1973–1977 were unjust and unreasonable, and its separate determination that ATR's rate base should be revised downward. We ordered refunds to customers of all ATR earnings above 12.9 percent of its adjusted rate base. The court affirmed this "excess earnings" (or "excess return") approach as a reasonable exercise of our discretion to award refunds, but called for further explanation of the Commission's refusal to adopt the customers' method of calculating the excess earnings pool under this approach. By *Order*, Mimeo No. 2675, released August 11, 1981, the Chief, Common Carrier Bureau, sought comments from interested

parties on the remanded issue. In response, Teleprompter Corporation, Rogers UA Cablesystems, Inc.,[1] United Cable Television Corporation (collectively "customers"), and ATR filed comments and replies. Consistent with the court's mandate, this order more fully explains the rationale for declining to adopt the customers' refund calculations, and concludes that the refund amount originally awarded was correct.

BACKGROUND

2. ATR is a miscellaneous microwave common carrier which, *inter alia*, carries the signals of four Los Angeles television signals to cable television systems in various parts of California, Texas, Arizona, and New Mexico (hereafter "LA service"). In 1972, ATR filed tariff revisions proposing to implement a new rate structure for this service. Charges were to vary in accordance with two factors: transmission distance to the subscribing cable system, and the population in the system's franchise area. In response to petitions from several ATR subscribers, the Commission instituted an investigation of these revisions, suspended their effectiveness for the full statutory period, and imposed an accounting order. *American Television Relay, Inc.*, 37 FCC 2d 751 (1972). The tariff revisions became effective January 11, 1973, while the investigation continued.

3. After hearings, the Chief, Common Carrier Bureau issued a recommended decision which upheld the population-sensitive aspect of ATR's proposed rate structure, but questioned its separation of customers into particular geographic zones. *See Recommended Decision*, 65 FCC 2d 387 (1977) ("R.D."). The *R.D.* also disputed some of ATR's rate base determinations and found that the return earned by ATR was unreasonably high, and authorized a rate of return for ATR between 12.9 and 14.5 percent. *Id.* On review, *ATR-I*, 63 FCC 2d 911 (1977), the Commission sustained certain reductions in the rate base made by the *R.D.*, and concluded that a range of 12.9 to 14.5 percent for ATR's rate of return was adequate. However, the Commission also found that ATR had not met its burden of proof in establishing that the population-sensitive element of its rate structure was just and reasonable. It therefore ordered ATR to file another revised tariff.[2]

4. The Commission next considered the issue of how to approach the excess earnings resulting from the downward revision of ATR's

[1] By letter dated February 1, 1982, we were informed that UA-Columbia Cablevision, Inc. changed its name to Rogers UA Cablesystems, Inc.

[2] In response to this order, ATR filed a revised tariff which eliminated the population-sensitive rates. We declined to suspend the revised tariff, but nonetheless ordered a second tariff investigation. ATR-II, 67 FCC 2d 527 (1978), ART-II Recon., 70 FCC 2d 1623 (1978). This investigation is still pending.

rate base, and the determination that its rates had generated an unlawfully high rate of return. The Commission was initially faced with the question of whether to delay any refund until a lawful rate structure was established, or to expedite a less finely detailed refund mechanism. After determining that an expedited, albeit less precise, refund was preferable, and examining several possible methods of calculation, the Commission adopted a two-step formula. Under it, ATR was first required to calculate its rates of return experienced in the years 1973 to 1977, based on the adjusted rate base prescribed in the *ATR-I* decision. Any return in excess of 12.9 percent was to be placed in the refund pool. Then, ATR was to allocate refunds from the pool to individual customers, according to the relation between the individual customer's rate increase and the total of all such rate increases. *ATR Refund*, 67 FCC 2d 703 (1978), *recon.* 70 FCC 2d 1631 (1978).[3]

5. Having settled upon this "excess return" refund-pool method, the Commission ordered ATR to devise a plan for the actual calculation and disbursement of the pool to its customers and submit it for approval. ATR in response proposed calculating the refund pool by multiplying the difference between the 12.9 percent rate of return permitted and the rate of return actually achieved each year, expressed as a percentage, by its adjusted rate base for each year. For the entire refund period from January 11, 1973 through September 20, 1977 this method resulted in a refund pool of $217,938 (plus interest at 6 percent).

6. ATR's customers opposed this method of calculating the refund pool. Since the Commission had reduced ATR's rate base and ordered it to refund revenues in excess of its allowed rate of return, they urged that certain components of ATR's revenue requirement which originally had been estimated as percentages of rate base and revenues—i.e., interest, tax, and general and administrative expenses—should also be revised downward. Specifically, they contended that because ATR's cost of debt for the LA service had originally been estimated by a proportional allocation of ATR's overall rate base, the rate base reduction prescribed by the Commission for the LA service required a corresponding reduction in the allowed interest expense. Likewise, allowable general and administrative expenses should be decreased, the customers argued, because those expenses had been allocated to the LA service as a percentage of anticipated total company revenues.[4] Thus, according to customers,

[3] Generally, the refund plan awards the largest refunds to customers most affected by ATR's population-sensitive tariffs, *i.e.*, those who received the greatest rate increases during the time the unlawful rates were in effect.

[4] The allocation of these expenses to the LA service involves two steps. Certain general and administrative expenses, for example, are initially allocated to ATR from the then parent corporation (Western Telecommunications, Inc. (WTCI)),

because the LA service's retained revenues had been decreased by our action, allowable general and administrative expenses must be proportionately diminished. The customers further asserted that as ATR's corporate income tax liability would be diminished by its reduced earnings, ATR's allowable tax expenses should also be lowered.

7. The customers contended that unless these additional expense adjustments were made, ATR's calculation of the refunds due for the 1973–1977 period would in effect allow the carrier to realize earnings in excess of its authorized 12.9 percent level. In contrast, they asserted, their alternative approach would nearly double the refund pool (including interest), while still constraining ATR's return to the 12.9 percent level. The Commission rejected the customers' contentions, finding ATR's calculation of the refund pool consistent with its decision in *ATR Refund, supra*. It explained that ATR was only required to adjust its depreciation reserve and plant in service figures before calculating the 12.9 percent rate of return baseline for refund purposes. *ATR Refund Proposal* at 132. These changes, the Commission stated, were required to adjust the test year rate base, as prescribed in *ATR*, for proper calculation of a 12.9 percent return—and thus of the liability which accrued in subsequent years to refund amounts exceeding that return.

8. As indicated, the court generally affirmed this decision. However, it said it was unable to follow the reasoning underlying the approval of a calculation method which, according to the customers, left ATR with a return higher than the 12.9 percent found just and reasonable. Consequently, it remanded the proceeding to the Commission for further explication of the refund rationale.[5]

COMMENTS

9. ATR's customers reiterate their position that the established reductions in ATR's rate base and rate of return require corresponding reductions in the amounts ATR is entitled to retain for interest, tax, and general and administrative expenses. As before, their

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based on ATR's expected contribution to overall revenues. Second, within ATR itself, these and other expense elements are allocated to the LA service, based on that service's expected contribution to overall ATR revenues.

[5] The court specifically requested clarification of the statement (in ATR Refund Proposals at 132) that the Commission "never intended a wholesale recalculation of ATR's entire rate base," when in fact it had ordered certain substantial changes in that rate base. Admittedly, the use of the term "rate base" in the quoted passage was an error. The passage should have referred to "revenue requirement." Thus, what the Commission meant to say was that it had not expected ATR to recalculate each element of its revenue requirement to determine the size of the refund pool. Rather, ATR was expected only to make "the adjustments to its rate base and rate of return prescribed in the ((ATR I)) decision." ATR Refund at 708. See also, ATR Refund Proposal, at 132. As noted here the adjustments to the expense portions of ATR's revenue requirement that the customers advocate were not prescribed in ATR I.

reasoning is that interest expense is a percentage component of ATR's allowed rate base, and therefore a reduction in the rate base requires a reduction in the allowable interest expense. Similarly, they argue that taxes and general and administrative expenses are a function of revenues; thus, if revenues are reduced, the amount allocated to taxes and general administrative expenses should also be reduced.

10. The customers assert that we would not have to conduct further proceedings to adopt their approach, but could easily calculate this modified refund on the basis of the existing record. The customers first note that ATR itself made such downward revisions in interest and tax expenses for 1977 when it filed its revised tariff removing the population-sensitive element from its rate structure.[6] Additionally, they point out that their calculations use the revised rate base we fixed in *ATR I*. The other figures used are either those supplied by ATR (and relied on by us in approving ATR's excess return calculations), or numbers derived from ATR's figures. By performing these calculations, the customers have determined that the refund pool should be $330,546 (plus interest).

11. For its part, ATR contends that the Commission should affirm its acceptance of ATR's refund computation. According to ATR, the excess return formula for refunds was based on a careful weighing of equitable considerations and a balancing of the interests of ATR and its customers. It argues that the Commission's previous orders clearly indicated that an ATR refund was not expected to include the expense adjustments the customers advocate. Thus, it further argues that adding the amount sought by the customers to the refund pool would be inequitable and unjust. In support, ATR asserts that the *ATR Refund* and *ATR Refund Recon.* orders found that a refund significantly higher than ATR's excess return could jeopardize ATR's financial situation, and adversely affect its ability to continue operating its system. It suggests that this is even more true today since its financial condition has deteriorated significantly over the past few years. ATR also contends that the customers' recalculation is based on a hypothetical manipulation of its expenses which ignores the reality that those expenses were actually incurred and could not be recouped or altered retroactively. It argues that if the Commission should decide to recalculate expenses, further proceedings are necessary to examine all its expenses and consider ATR's financial situation and ability to pay further refunds, without jeopardizing service to subscribers.

DISCUSSION

12. Initially, it should be emphasized that the Commission's

[6] See, ATR's Transmittal No. 78, filed June 22, 1977, and No. 81, filed March 8, 1978.

"excess return" approach to calculating refunds is not at issue on remand. The court explicitly affirmed the Commission's exercise of statutory discretion to devise a refund methodology balancing the various investor, ratepayer, and public interests involved. It found that the Commission reasonably rejected the alternative refund plans urged by the customers, even though they might have produced a larger or more accurate refund. *Las Cruces, supra*, at 1048-50. The only issue the court remanded to the Commission related to "the customers argument that not recalculating ATR's expenses in response to changes in its rate base and revenues would provide ATR with a rate of return above the 12.9% figure found just and reasonable." *Id.* at 1051.[7] Simply put, the court wanted an explanation as to why the Commission found this argument to be unacceptable.

13. Upon reexamination of the record of this proceeding and consideration of the comments filed by the parties the Commission has decided to reaffirm its earlier conclusion that ATR is not required to make the expense adjustments that the customers want in calculating the size of the refund pool. Before turning to the specifics of the customers' argument, we note that the objective in adopting this "excess return" refund formula was to arrive at a refund amount that would provide rough justice for the parties. As explained in *ATR Refund*, there are equitable considerations present in this case which require a balancing of carrier and customer interests. *ATR Refund* at 708–711. Because the balance struck in that decision would be upset by the adjustments that the customers demand,[8] we believe they are required to present compelling legal and/or equitable evidence that these adjustments are necessary before we order ATR to make them. For the reasons set forth below, we find that the customers have not satisfied this requirement.

14. The customers have not shown that failure to make these adjustments would provide ATR with a rate of return above 12.9% for the refund years. The customers' calculations are based upon their assumption that the portions of ATR's expenses they challenge were as a logical matter disallowed by the Commission orders.[9] They

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[7] Although the Commission elected to employ a 12.9 rate of return figure for calculating the refund pool in this case, its orders did *not* conclude that 12.9 was the maximum reasonable rate of return for ATR. Rather, it found that ATR's rates would fall within an appropriate zone of reasonableness even if they produced a rate of return as high as 14.5%. See ATR I, at 932.

[8] We specifically reject the customer's assertions that the refund orders directed ATR to make the adjustments they want. The Commission ordered adjustments to ATR's depreciation reserve and amount of plant in service only. See ATR Refund, at 707. As explained at fn. 5, ATR was not required to recalculate each element of its revenue requirement formula for the purpose of this refund. Thus, as we indicated in our public notice announcing the refund, we expected the refund pool to be about $228,000 without interest — not the $330,546 plus interest claimed by the customers.

contend that the rate base adjustments and refunds ordered *require* the further adjustments they advocate. We disagree.[10]

15. The fact that ATR assigned certain expenses to its LA service as percentages of its rate base and revenues does not lead ineluctably to a conclusion that those expenses became unreasonably high when the Commission later ordered rate base and revenue reductions. Ratemaking is not a precise science; carriers are permitted reasonable leeway in developing methods for assigning claimed expenses to a given service in the ratemaking process. Nothing in the record of this proceeding indicates that the levels of expenses that ATR claims it incurred during the refund years necessarily are unreasonable or result in rates which are outside the zone of reasonableness. Our orders did not prescribe any particular methodology for calculating expenses for the LA service nor in any way limit the level of expenses that ATR could claim. Indeed, the customers have not presented any evidence to indicate that these expenses were not incurred or are so patently unreasonable that they should be disallowed.

16. We believe that the refund pool calculated by ATR in response to our orders provides a fair and reasonable refund to the customers, under all the circumstances of this case. We disagree with the customers assertions that the recalculations they want are necessary to prevent a windfall to ATR. Nothing in this record suggests that the expenses claimed are anything but costs of doing business which ATR is entitled to recover. With regard to G&A expenses, for example, we see no evidence that such expenses would lessen as a result of our orders. The revenues which ATR collected do not change on account of the refunds; nor have customers offered any basis for their assertion that expenses allocated on the basis of revenues collected, such as G&A expenses, have somehow diminished because of the refunds. We thus see no basis for concluding that ATR is not entitled to recover the costs incurred in achieving

[9] For example, they state (Comments at 5): "since the [income] taxes paid by a company are functions of the amount of revenue collected, it naturally follows that the amount allocated to this expense item *must* be reduced if the amount of revenues collected is reduced [note omitted]." Customers go on to assert that G&A expenses are somewhat more difficult to adjust because they are a "function" of total revenues received, but *some* adjustment is necessary because "the amount of total revenues is being decreased." (Comments at 10–11).

[10] The customers also contend that FPC v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962) requires the result they want. We reject this argument because we find the customers incorrectly interpret Tennessee Gas in a way that would limit our discretion in devising appropriate refund mechanisms. Tennessee Gas did not purport to circumscribe the regulator's discretionary determination whether refunds should be awarded, or how the competing interests involved should be balanced; it held only that a two stage refund procedure mandated by the Federal Power Commission was not defective as an exercise of that agency's authority to order refunds. Indeed, the reading customers urge contradicts the extended discussion of agency discretion in the remand order involved here, 645 F.2d at 1047–1048.

their collected revenues. Similarly, we see no reason to alter ATR's tax computations for the purposes of this refund. Again, ATR incurred tax liability for the refund years on the basis of its operating results in those years. It is entitled to include that tax liability in its rate calculations. Any tax advantages that ATR may receive from the refund we have ordered, may lower the carrier's revenue requirement in the year realized. Thus, we see no reason to include this amount in the refund pool. Finally, we disagree with the customers' assertion that ATR's interest expenses must be recalculated. Because cost of debt is a component of the rate of return, an adjustment of ATR's interest expense has already been accomplished by our action limiting the carrier's rate of return to 12.9%.

17. In conclusion, we are denying customers' request for increased refunds. The expenses shown for the LA service seem legitimate and we see no reason to deprive ATR of the revenues with which it would cover these expenses. Inasmuch as we allow these expenses to stand and form a part of the LA service's revenue requirement, the customers' claim that ATR will have earned an excessive return in the years 1973 to 1977 is unfounded.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Forfeiture Notice of Apparent Liability
Rules, Violation of

Notice of Apparent Liability and Orders issued to Northwestern Bell and American Bell, Inc, for violation of Computer II Rules, 77 FCC 2d 384 (1980).
–AT&T Co.

FCC 83–514

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
AMERICAN TELEPHONE & TELEGRAPH CO.	ENF 83–36
Notice of Apparent Liability for Forfeiture	

NOTICES OF APPARENT LIABILITY AND ORDERS

(Adopted: November 8, 1983; Released November 17, 1983)

BY THE COMMISSION:

1. These Notices of Apparent Liability for Forfeitures are issued pursuant to section 503(b) of the Communications Act of 1934, 47 U.S.C. § 503(b), as amended, and section 1.80(f) of the Commission's Rules, 47 C.F.R. § 1.80(f).

2. American Telephone & Telegraph (AT&T) has apparently incurred liability for actions of its agents, AT&T Information Systems (ATTIS, formerly American Bell Inc.) and Northwestern Bell Telephone Co. (Northwestern), pursuant to section 217 of the Act. AT&T and Northwestern are held jointly and severally liable for the forfeiture amounts in recognition of both parties' responsibilities to comply with our Rules. Liability has been incurred in the amount of $20,000 for each of the following groups of willful and repeated violations of the Commission's Rules in connection with the manner in which Northwestern detariffed embedded CPE in Iowa and transferred it to ATTIS, AT&T's separate subsidiary formed pursuant to Computer II:[1]

(a) Northwestern's provision to ATTIS of operating, billing, service order processing, marketing, installation and maintenance support services for

[1] Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer II), 77 FCC 2d 384 (1980) (Final Decision), *reconsideration*, 84 FCC 2d 50 (1980), *further reconsideration*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer & Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 103 S.Ct. 2109 (1983).

deregulated customer premises equipment (CPE) without satisfying the separation conditions contained in section 64.702(c) of the Commission's Rules.

(b) Northwestern's provision to ATTIS of the promotion and sale of deregulated CPE in violation of section 64.702(d)(1) of the Commission's Rules.

(c) Northwestern's provision to ATTIS of access to Northwestern's computer systems used to provide common carrier communication services in violation of section 64.702(d)(2) of the Commission's Rules.

(d) Northwestern's provision to ATTIS of Northwestern's customer proprietary information without making available that information to the public on the same terms and conditions in violation of section 64.702(d)(3) of the Commission's Rules.

3. In a proceeding which culminated in a February 9, 1983 order, the Iowa Commerce Commission (Iowa) ordered that telephone companies within its jurisdiction take action to deregulate CPE, including embedded CPE.[2] On May 26, 1983, two weeks prior to the date on which Northwestern proposed to deregulate its Iowa CPE, Northwestern requested this Commission to permit it to provide deregulated equipment without complying with the structural separation requirements the Commission adopted in the Computer II decisions. In responding to Northwestern's request, the Bureau endorsed Iowa's action requiring carriers to deregulate embedded CPE and noted that the Commission has consistently encouraged states to take the initiative in deregulating CPE. Nevertheless, the Bureau dismissed Northwestern's petition for waiver. Northwestern was advised in that dismissal that any detariffed CPE could only be provided by AT&T's separate subsidiary, ATTIS, and instructed Northwestern to file a report indicating its compliance with the Computer II structural separation requirements if it deregulated CPE. The day after the Bureau's action, which left in place Computer II's prohibition against the support by Northwestern of deregulated CPE on an unseparated basis, Northwestern by motion requested Iowa to detariff immediately CPE in Iowa, even though Iowa had earlier refused to permit Northwestern's tariff deregulating CPE to become effective pending an investigation of the legality of the tariff. Northwestern's motion was eventually granted by Iowa until the conclusion of the Iowa investigation. Northwestern then transferred all Iowa CPE to ATTIS, although support functions, which the Rules prohibit the operating companies from providing to ABI, continued to be provided by Northwestern.

4. Based on responses by Northwestern which are before us, *see* paras. 9–10 *infra.*, we are in a position to summarize the above-described events as follows. On June 25, 1982, Iowa commenced a

[2] Embedded CPE is that equipment which is subject to the jurisdictional separations and settlements process as of January 1, 1983, which included CPE located on customer's premises or in telephone company inventory as of that date. *See Further Reconsideration*, 88 FCC 2d at 525–26.

rulemaking proceeding in which it proposed to deregulate the provision of CPE by telephone companies.[3] Northwestern filed comments in that proceeding on August 30, 1982. Northwestern at that time stated to the Iowa Commission that if it were to deregulate embedded CPE prior to the time the FCC reached a final decision in the *Implementation Proceeding*, 89 FCC 2d 694 (April 13, 1982), Northwestern might be unable to offer CPE for failure to comply with the separation conditions of the Computer II rules. Comments of Northwestern Bell Telephone Co. filed in Docket RMU 82–1, at 20 n.** (August 25, 1982).

5. After oral presentations by Northwestern and other Iowa telephone companies, Iowa issued an order on November 19, 1982, adopting amended proposed rules. Those rules required telephone companies to file within 120 days of the effective date of the rules tariffs which identified a date certain, to be selected by each telephone company, upon which embedded CPE would be detariffed in Iowa. After a further round of pleadings and additional oral presentations, Iowa issued a final order on February 9, 1983 to implement the proposed rule changes deregulating the offer of CPE in Iowa. That Order required all telephone companies, including Northwestern, to submit tariffs no later than June 6, 1983. The Order required that these tariffs include a date certain, to be selected by the company, on which deregulation of CPE would be effective. Iowa stated it would "no longer regulate the provision of CPE and its associated services, and utilities who choose to continue in the CPE market will be governed by the forces of competition." In re Deregulation of the Terminal Equipment Market for Intrastate Telephone Utilities, Docket RMU-82–1 (Iowa Commerce Commission, issued Feb. 9, 1983).

6. On May 6, 1983, Northwestern filed its tariff with Iowa proposing to deregulate all of Northwestern's CPE in Iowa effective June 8, 1983. On May 27, 1983, nine months after Northwestern informed Iowa that deregulating embedded CPE could preclude Northwestern from offering deregulated CPE on account of the Computer II separation requirements and almost four months after Iowa issued its final order requiring that Iowa CPE be deregulated, Northwestern filed a petition for waiver with this Commission requesting permission to provide deregulated embedded CPE in Iowa on an unseparated basis after June 8, 1973 until January 1, 1984. That petition asserted that accounting separation, the details of which Northwestern would present to the Commission at a later time, would be adequate to satisfy the Commission's concern that cross-subsidization would be detectable and that anticompetitive practices would be prevented. Northwestern submitted that the

[3] In re Deregulation of the Terminal Equipment Market for Intrastate Telephone Utilities, Docket No. RMU 82–1 (issued June 25, 1982).

waiver was necessary to comply with a detariffing order of the Iowa Commission. On June 3, 1983, the Iowa Commission deferred indefinitely the effective date of Northwestern's tariff deregulating its CPE.[4]

7. Northwestern's Petition for Waiver of the Computer II rules was dismissed by the Chief of the Common Carrier Bureau on June 7, 1983 because Northwestern failed both to set forth sufficient facts to warrant a grant of the relief requested and to file the petition in a timely manner. Letter from Gary M. Epstein to Northwestern Bell Telephone Co. (June 7, 1983). That dismissal noted that, during the Computer II proceeding, the Commission had already rejected AT&T's arguments that accounting separation was adequate to protect against cross-subsidization and other anticompetitive abuses. Thus, Northwestern's assertion that accounting separation would protect ratepayers and equipment competitors was rejected. The letter concluded that deregulated CPE could only be provided by ATTIS, since it was the only AT&T separate subsidiary formed to provide deregulated products and services. The Bureau required that any deregulated CPE be transferred to ATTIS and directed Northwestern to file a report with this Commission indicating "its compliance with the Commission's Computer II structural separation requirements." *Id.* at 4. Northwestern and AT&T were both orally informed of the dismissal on June 7 by a member of the Bureau staff and copies of the June 7 letter were immediately made available to them.

8. On June 8, 1983, one day following the Bureau's dismissal of Northwestern's waiver request and the oral notification of that dismissal, Northwestern filed a motion with Iowa requesting that Northwestern's May 6 tariff deregulating CPE be put into effect immediately on a temporary basis subject to the outcome of the pending Iowa investigation. On June 30, 1983, Iowa issued an order permitting Northwestern to put into effect its tariffs deregulating CPE on a temporary basis until the outcome of Iowa's investigation was completed. By resolution of the board of directors of ATTIS and Northwestern, CPE was transferred retroactively to ATTIS effective June 8, 1983. At the same time state-tariffed CPE was deregulated and transferred to ATTIS, AT&T transferred federally tariffed CPE to ATTIS.

9. On June 28, 1983, the Chief of the Common Carrier Bureau by letter advised Northwestern that the Bureau had become aware that Northwestern was providing embedded CPE for ATTIS on a detariffed basis and that the way in which this offering was made was not in compliance with the Computer II structural separation require-

[4] That deferral was accomplished by issuing an Order in Docket No. SPU-83-5 (TF-83-268) instituting an investigation with respect to whether Northwestern's May 6 tariff filing complied with Iowa Commerce Commission Rules and the registration program conducted pursuant to Part 68 of the FCC's Rules.

ments. The Bureau requested Northwestern to provide additional information from which to determine the extent of any violation. Northwestern responded by letters dated June 29 and July 8, 1983. In each instance, Northwestern conceded that it was not presently in compliance with the Computer II requirements but that it intended to bring itself into compliance in the future. Also, on June 30, 1983, AT&T submitted a schedule of the actions it would take to bring the detariffing of CPE in Iowa into compliance with the Computer II rules. In addition, on July 11, 1983, AT&T filed a contract entered into between Northwestern and ABI concerning Northwestern's provision of service order processing, billing and collection services to support the CPE which was transferred to ABI effective June 8, 1983. AT&T has also submitted a document dated September 8, 1983, which is Amendment No. 2 to the installation and maintenance contract between Northwestern and ATTIS for the provision of installation and maintenance of ATTIS' complex business CPE.[5] On August 1, 1983 AT&T supplemented its June 30 report regarding the status of its noncompliance with the Computer II rules. On November 4, 1983 AT&T filed a further report which indicated AT&T's compliance efforts were proceeding as scheduled.

10. From the documents provided to the Commission and a review of the Iowa record, it must be concluded that the manner in which Northwestern detariffed CPE in Iowa and transferred it to ATTIS was willfully conducted in violation of the Commission's Computer II rules. Even though Iowa had not yet approved Northwestern's proposed detariffing by order of June 3, and in spite of the Bureau's June 7 dismissal action, Northwestern intentionally motioned Iowa on June 8 to approve detariffing prior to the time such action would have been taken by Iowa without such a motion. Northwestern Bell and ATTIS repeatedly continue to violate the Commission's Computer II rules.

11. ATTIS owns CPE assets in Iowa effective June 8, 1983 and it has been earning and continues to earn and receive revenues from that CPE. Northwestern is providing billing, collection and service order entry services to support ATTIS's CPE, all in violation of the structural separation requirements in section 64.702(c)(2) of the Commission's Rules. Northwestern will bill ATTIS's CPE customers for a monthly rental, will collect revenues for ATTIS, and will take orders for repairs, rearrangements and changes of in-place CPE. The

[5] The Commission has permitted the BOCs to provide installation and maintenance services to ATTIS for complex business CPE until July 1984, *Further Reconsideration*, 88 FCC 2d at 532–33, but not for residential and simple business CPE. Through the course of routine monitoring of the contract for the provision of installation and maintenance services for complex business CPE we have obtained evidence that ATTIS is probably not being billed pursuant to the contract for installation and maintenance of embedded equipment transferred to ATTIS in Iowa. The results of this investigation are as yet incomplete.

same personnel who bill, collect revenues and take orders for CPE also perform those same functions for transmission services.

12. Northwestern is providing installation and maintenance services in support of ATTIS's residential and simple business CPE in violation of section 64.702(c)(2) of the Rules. In addition, Northwestern and AT&T are making available computer systems to ATTIS to support the provision of ATTIS CPE in violation of section 64.702(d)(1). Those systems include a wide variety of software providing access to and organization of loop maintenance data bases, financial records, customer billing information systems, service order processing data bases, inventory management systems, product-group specific revenue data and asset management records. Those records contain not only vast amounts of customer proprietary information, but also financial and market planning information as well. In addition, the contract between Northwestern and ATTIS provides unrestricted access by ATTIS to the above-described Northwestern customer proprietary information, while prohibiting that such information be disclosed to third parties, in violation of section 64.702(d)(3) of the Commission's Rules.

13. Northwestern is engaging in the sale and promotion of CPE on behalf of ATTIS in violation of section 64.702(d)(1) of the Commission's Rules. This promotion and sale is occurring in two contexts. First, Northwestern is selling CPE to existing residential customers on ATTIS's behalf. Second, Northwestern service order entry personnel are referring current customers to ATTIS, which is the owner of in-place equipment, although AT&T has represented that Northwestern employees are instructed to advise customers who require new CPE that alternative vendors provide CPE. Notwithstanding, AT&T has also stated that Northwestern will continue to handle the customer's request for new CPE if the customer so requests.

14. In addition, ATTIS currently has access to Northwestern customer proprietary information. One of the example of such access is the contractual right of ATTIS to demand customer mailing labels from Northwestern. Another example is access to Customer Records Information System billing records which identify the equipment a customer currently uses. The provision to and sharing with ATTIS of customer proprietary information without customer permission and without disclosure to the public violates Computer II.

15. For the first time in its August 31 supplemental status report AT&T raises the argument that it was forced to violate the Computer II rules. AT&T argues that it could not comply with two conflicting orders, the first being Iowa's order to detariff Iowa CPE and the second being the Bureau's requirement that detariffed CPE be immediately transferred to ATTIS. This argument is disingenuous. First, the June 8 date for detariffing Iowa CPE was a date selected by Northwestern and not Iowa. In addition, effective June 3

Iowa had suspended Northwestern's implementing tariff deregulating CPE in Iowa. Northwestern moved to put that tariff into effect prior to the date on which Iowa would have made the tariff effective without such motion. Second, the Bureau did not require the immediate transfer of CPE to ATTIS. It did state, in the context of a dismissal of a waiver petition seeking relief from the structural separation rules, that detariffed CPE could only be provided through a separate subsidiary. In Northwestern's case this was ATTIS. In dismissing Northwestern's request for a waiver of the Computer II rules the Bureau's letter contemplated transfer after AT&T had made appropriate arrangements for the assumption by ATTIS of all support functions for Iowa embedded CPE. In these circumstances, AT&T cannot legitimately argue that it was forced to violate Computer II.

16. AT&T and Northwestern have represented to the Commission that they are taking steps to comply with the Computer II rules. A statement of future compliance does not preclude a finding of apparent liability, particularly where, as here, a failure to comply with the rules is entirely in the hands of the offending parties. At any time following the Iowa Commission's notice of June 25, 1982 that it was considering detariffing CPE within its jurisdiction Northwestern could have prepared to transfer that CPE to ATTIS or to a separate subsidiary of its own creation, subject to the Computer II requirements. Instead, AT&T and Northwestern filed a contract and timetables with the Commission, including a recitation of accounting procedures to bill ATTIS for Northwestern's cost of supporting ATTIS CPE. Those steps are insufficient to justify a claim of compliance with the Commission's Rules or a Bureau directive.

17. In its June 30 letter, AT&T requests that a waiver of Computer II be granted in order for it to effect the proposed transitional arrangements until Iowa CPE can be supported entirely by ATTIS. Letter from Francine J. Berry to Gary M. Epstein, at 11 n.* (June 30, 1983). A similar waiver request was dismissed on June 7, 1983 by Bureau letter. Furthermore, it is improper, as Northwestern and AT&T have done, either to violate the rules and then request a waiver afterwards or to continue to violate the rules pending a decision with respect to a waiver. Because of Northwestern's and AT&T's failure to have "clean hands" when seeking relief from this Commission, this belated waiver request must be denied. *See Ashtabula Cable TV, Inc. v. Ashtabula Telephone Co,*, 17 FCC 2d 113, *recon. denied*, 18 FCC 2d 193 (1969).[6]

[6] Although Northwestern has argued that potential customer dislocation is the reason unseparated operations are currently necessary, that argument does not support Northwestern's decision to abruptly deregulate CPE and in a manner which violates Computer II despite its actual knowledge for over nine months that it should inform this Commission of any problems regarding the application of Computer II.

18. Therefore, within sixty days of the release of this order, Northwestern and ATTIS shall bring themselves into full compliance with Computer II. This action will necessitate a transfer of all CPE support functions to ATTIS within 60 days. If that transfer has not been accomplished by that time Northwestern shall cease all support functions for ATTIS's CPE except installation and maintenance of business CPE and billing services provided that ATTIS assumes billing responsibilities by November 1, 1983.

19. Furthermore, Northwestern shall make available to any equipment supplier all customer proprietary information that Northwestern has provided ATTIS in violation of Computer II. Northwestern shall provide a list, both at Northwestern's Iowa business offices and to this Commission, of each instance customer proprietary information is provided to ATTIS and make available until further notice that customer information to equipment suppliers upon request. That list should be updated as any future information provision in violation of our Rules occurs. ATTIS is under a continuing duty to cooperate with Northwestern and equipment providers to supply the necessary information.

20. Some customers may wish, however, to keep confidential customer proprietary information in the hands of Northwestern or ATTIS relating to themselves. Therefore, AT&T shall notify as soon as possible all Iowa customers that they may object to the disclosure of information relating to them by mailing each of those customers the following notice:

> AS YOU WERE INFORMED IN AN EARLIER CIRCULAR, DUE TO AN ACTION OF THE IOWA COMMERCE COMMISSION, TELEPHONE EQUIPMENT USED BY YOU HAS BEEN DEREGULATED. AT&T INFORMATION SYSTEMS NOW OWNS YOUR EQUIPMENT RATHER THAN NORTHWESTERN BELL. BECAUSE NORTHWESTERN BELL HAS PROVIDED INFORMATION REGARDING YOUR TELEPHONE SERVICE AND EQUIPMENT TO AT&T INFORMATION SYSTEMS, FEDERAL COMMUNICATIONS COMMISSION REGULATIONS REQUIRE THAT THIS INFORMATION ALSO BE MADE AVAILABLE TO OTHER EQUIPMENT SUPPLIERS UNLESS YOU OBJECT. PLEASE FILL OUT THE ENCLOSED PREPAID POSTCARD AND MAIL IT TO NORTHWESTERN BELL AS SOON AS POSSIBLE. IF YOU DO NOT RESPOND WITHIN 30 DAYS, INFORMATION REGARDING YOUR SERVICE AND EQUIPMENT WILL BE AVAILABLE TO OTHER EQUIPMENT SUPPLIERS.
>
> Name _____ Date _____
> Address _____
> Contact (If you are a company) _____
> Telephone Number _____
>
> [ ] You may disclose the information Northwestern has or will make available to AT&T Information Systems to equipment suppliers.

[ ] You may disclose the information Northwestern has or will make available to AT&T Information Systems to only the following equipment suppliers (list suppliers):

_____

_____

_____

_____

[ ] Do not disclose the information Northwestern has or will make available to AT&T Information Systems to any equipment suppliers.

21. We find that AT&T owns and controls both AT&T Information Systems and Northwestern and that therefore it is responsible for their actions as outlined by virtue of the provisions of Section 217 of the Act, 47 U.S.C. §217.

22. We further note that Northwestern Bell has apparently incurred liability pursuant to the provisions of Section 203(e) of the Act in that they transferred to detariffed status equipment which, under Computer II, was permitted to be detariffed solely in accordance with the provisions of Section 64.702 of the Commission's rules. Therefore, this equipment was thereafter provided to the public inconsistently with our rules and statutory requirements governing the tariffed offering of service. While we believe that in this case the forfeiture provisions of Sections 203(e) and 503 of the Act are not mutually exclusive, because the violation which would give rise to the forfeiture provisions are different, we shall not seek at this time to impose the $500 plus $25 per day forfeiture for each offense and $25 for each and every day of the continuance of such offense specified in Section 203(e). We expect that the carrier will discontinue its current violations of our rules. However, we hereby give notice that should these violations continue after the time for correction has passed as stated in this Order, we reserve the right to impose the statutory forfeitures of Section 203(e), in addition to other forfeitures, for violations occurring after this order is served.

23. Wherefore, IT IS ORDERED that pursuant to Sections 217 and 503(b) of the Communications Act of 1934, as amended, and section 1.80 of the Commission's Rules and Regulations, American Telephone and Telegraph Co. and Northwestern Bell Telephone Co. are apparently jointly and severally liable for a forfeiture of $20,000 for the willful and repeated provision by Northwestern Bell Telephone Co. to AT&T Information Systems, Inc. of operating billing, service order processing, marketing, installation and maintenance support services for deregulated customer CPE in violation of the separation conditions of section 64.702(c) of the Commission's Rules.[7]

[7] Because the background leading up to each of these apparent rule violations is the same, we have, for administrative convenience, consolidated these separate notices of apparent liability in a single document. We wish to make clear, however, that we regard each of the different acts or ommissions described above as separate violations of our Rules. Because we have assessed the maximum statutory penalty

24. IT IS FURTHER ORDERED that pursuant to Sections 217 and 503(b) of the Communications Act of 1934, as amended, and section 1.80 of the Commission's Rules and Regulations, American Telephone and Telegraph and Northwestern Bell Telephone Co. are apparently jointly and severally liable for a forfeiture of $20,000 for the willful and repeated provision by Northwestern Bell Telephone Co. to AT&T Information Systems of the promotion and sale of deregulated CPE in violation of section 64.702(d)(1) of the Commission's Rules.

25. IT IS FURTHER ORDERED that pursuant to sections 217 and 503(b) of the Communications Act of 1934, as amended, and section 1.80 of the Commission's Rules and Regulations, American Telephone and Telegraph Co. and Northwestern Bell Telephone Co. are apparently jointly and severally liable for a forfeiture of $20,000 for the willful and repeated provision by Northwestern Bell Telephone Co. to AT&T Information Systems, Inc. of access to Northwestern's computer systems used to provide common carrier communication services in violation of section 64.702(d)(2) of the Commission's Rules.

26. IT IS FURTHER ORDERED that pursuant to Sections 217 and 503(b) of the Communications Act of 1934, as amended, and section 1.80 of the Commission's Rules and Regulations, American Telephone and Telegraph Co. and Northwestern Bell Telephone Co. are apparently jointly and severally liable for a forfeiture of $20,000 for the willful and repeated provision by Northwestern Bell Telephone Co. to AT&T Information Systems, Inc. of Northwestern's customer proprietary information without making available that information to the public on the same terms and conditions in violation of section 64.702(d)(3) of the Commission's Rules.

27. IT IS FURTHER ORDERED that unless the American Telephone and Telegraph Co. and Northwestern Bell Telephone Co. avail themselves of the rights and procedures outlined in Section 1.80 of the Commission's Rules, 47 C.F.R. 1.80, they shall pay in full the amount of the accrued forfeiture within 10 days of the date of these Notices of Apparent Liability and Orders and such payment shall be accompanied by a statement declaring that Northwestern Bell will be in full compliance with Computer II within 60 days of the release of this order consistent with the terms of this order. Payment should be made by check or money order drawn to the order of the FCC, 1919 M Street, N.W., Room 452, Washington, D.C. 20554.[8]

28. IT IS FURTHER ORDERED that the Secretary shall send by certified mail a copy of these Notices of Apparent Liability for Forfeitures to American Telephone & Telegraph Co., 195 Broadway,

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for each group of violations, the total amount of the forfeitures assessed against the company is $80,000.

[8] Such a forfeiture amount should be booked to account 370, "Extraordinary income charges," which is a below-the-line account. 47 C.F.R. §31.370.

New York, New York, 10007, to the attention of Ms. Francine Berry and to Northwestern Bell Telephone Co., 909 High Street, Des Moines, Iowa 50309, to the attention of Mr. David Sather.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Charges
Common Carrier, Like Services
Common Carrier, Rates, Charges, Inconsistent Pricing
Rate, Structure
Tariff, Discrimination

Commission upheld requirement in Group/Supergroup Order, 92 FCC 2d 1217 (1983), that AT&T offer group and supergroup interexchange channels under a general rate schedule applicable to all services using the channels.
-AT&T
Docket No. 21499

FCC 83-550

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of AMERICAN TELEPHONE AND TELEGRAPH COMPANY Offer of Facilities to Other Common Carriers	Docket No. 21499

ORDER ON RECONSIDERATION

(Adopted November 23, 1983; Released December 12, 1983)

BY THE COMMISSION:

1.—In a Memorandum Opinion and Order and Further Notice of Proposed Rulemaking (Order) released February 15, 1983,[1] the Commission directed the American Telephone and Telegraph Company (AT&T) to offer group and supergroup channels[2] to other common carriers (OCCs) and to the public and sought further comments on related issues. The Commission required AT&T to offer group and supergroup interexchange channels under a general rate

[1] American Telephone and Telegraph Company (Group/Supergroup Order), 92 FCC 2d 1217 (1983) 48 Fed. Reg. 7596 (February 23, 1983).

[2] Group and supergroup channels are analog channels with nominal bandwidths of 48 kHz and 240 kHz respectively. A group channel may be used to transport bundles of up to twelve nominal 4 kHz voice channels and supergroups may be used for bundles of up to sixty voice channels. In addition, groups and supergroups may be used to fulfill a variety of private line service requirements. They may be utilized to carry voice-grade, subvoice-grade, high and low speed data, or any combination of these signals. See Order, paras. 3 and 4.

schedule applicable to all services using the channels. AT&T seeks partial reconsideration of the Order to the extent that it requires AT&T to apply the general rate schedule for group and supergroup interexchange channels to the interexchange portion of wideband services.[3] Western Union Telegraph Company (Western Union) petitions for reconsideration to clarify that the Order does not foreclose entities other than AT&T or the Bell Operating Companies (BOCs) from providing local distribution for group and supergroup facilities. Western Union requests that any questions involving OCC-provided local distribution be addressed in the further inquiry in this proceeding. For the reasons set forth below, we deny AT&T's Petition for Partial Reconsideration and defer action on Western Union's Petition for Reconsideration.

BACKGROUND

2. In its Order, the Commission concluded that the availability of group and supergroup services under general tariff schedules would benefit the public, and that AT&T had failed to justify its refusal to provide those services to the public upon reasonable request as required by Section 201(a) of the Communications Act.[4] Order, para. 27. The Commission was unable to determine on the then existing record, however, whether the local and interexchange portions of these channels could be unbundled from AT&T-provided terminal equipment or whether existing local plant could be used for local distribution of the service. The Commission requested additional comments on these issues. In the interim, the Commission permitted AT&T to file the required tariff provisions for group and supergroup facilities conditioned on the need for special construction of local distribution channels. The interexchange portion of the service, however, was to be filed under a general rate schedule applicable to all services which utilize group and supergroup channels, whether involving full carrier system or wideband service. This was necessary, the Commission stated, in order to minimize opportunities for discriminatory practices.[5]

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[3] The term "wideband" describes a service arrangement which uses facilities of the group and supergroup type for long-haul or intercity transmission of signals requiring greater than analog voice channel capacity. Order, para. 3, n. 3. Wideband services offered by AT&T are the 50 kilobit per second (kbps) and 56 kbps services offered under Tariff FCC No. 260 and 230.4 kbps service offered under Tariff F.C.C. No. 258. Petition for Partial Reconsideration, 2, n.*. By contrast, "full carrier system" offerings (sometimes referred to as "broadband" offerings) are those requiring the full group or supergroup carrier system bandwidth, *i.e.*, 48 kHz or 240 kHz. Order, para. 4, n.5.

[4] 47 U.S.C. §201(a).

[5] Order, para. 28. The Commission's experience has been that development of rates on an individualized basis, rather than on a general rate schedule basis, creates a potential for unreasonable price discrimination. *Id.*, n. 41.

3. AT&T filed its tariff revisions on March 17, 1983 (Transmittal No. 14245).[6] AT&T stated that although its tariff for the interexchange services "fully complies with the mandate that group and supergroup circuits and facilities be offered on a general tariff basis," it does not meet the requirement of paragraph 28 of the Order that the interexchange portion be filed under a general rate schedule applicable to all users since it does not apply to wideband services.[7] These revisions became effectie June 15, 1983.[8]

4. AT&T filed its Petition for Partial Reconsideration of the general rate schedule issue simultaneously with its tariff revisions. AT&T contends in its petition that the Commission based its requirement that the general rate schedule be applied to wideband services on certain erroneous assumptions. First, AT&T states, no interexchange rate elements presently exist for the 230.4 kbps wideband service and, in light of the "limited demand" for that service, development of interexchange rates for it should not be required. Petition, 3, n. *. Second, AT&T maintains, current wideband interexchange rates include costs for some functions (such as wideband service bays, digital modems, analog modems and special conditioning) not required in provision of group and supergroup facilities and, therefore, not properly includable in rates for those facilities. Conducting the necessary studies to identify and eliminate those cost elements from wideband interexchange rates, AT&T states, would require at least four months. Petition, 3–4. Finally, even if this were done, AT&T continues, the rate thus developed would still reflect costs unrelated to the cost of providing interexchange full carrier system group and supergroup services since the

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[6] In order to avoid any delay in the offering of group/supergroup services pending development of extensive cost support and other tariff-related material, the Common Carrier Bureau granted AT&T special permission to file its group and supergroup interexchange channel rates based on the Series 2000 and 3000 voice channel rate schedules, known as the Multischedule Private Line (MPL) voice grade schedules, in Tariff No. 260. Special Permission No. 83–142. On April 11, 1983, Western Union filed a Petition for Amendment of Order requesting the Commission to set a date certain for the filing of a cost-supported tariff for group and supergroup services. AT&T moved to strike the petition as neither authorized by the rules nor solicited by the Order. Furthermore, AT&T stated, it planned to file new tariffs for this service (as well as all other interstate services) in October 1983 in connection with the divestiture of the Bell Operating Companies. Those tariffs have been filed along with cost support material.

[7] Special Permission Application No. 1725, n. ****.

[8] In its order allowing the tariff revisions to take effect, the Common Carrier Bureau set for investigation AT&T's requirement that only AT&T-supplied Network Channel Terminating Equipment, to be located at customer premises, be used. The Bureau also found that although it could reject the tariff for failing to comply with the Order's general rate schedule requirement, the public interest would be better served by permitting the tariff to go into effect pending resolution of that issue on reconsideration of the Order. American Telephone and Telegraph Company (Group/Supergroup Tariff Order), Mimeo No. 4821, released June 20, 1983, para. 10.

basic transmission facilities used for interexchange wideband services differ from those used to provide interexchange full carrier system group and supergroup services. A single general rate schedule for these services, AT&T concludes, is therefore not appropriate. Petition, 4–5.

5. Western Union's Petition for Reconsideration requests that the Order be clarified to state that local distribution of wideband-based or full carrier system group and supergroup channels may be provided over non-AT&T provided facilities. Western Union states that although the Order appears to overlook alternatives to AT&T-provided facilities, such as local distribution by other carriers, nothing in the Order indicates an intention to preclude such offerings. Furthermore, Western Union argues, competitive offerings of local distribution facilities could further the Commission's goal of making group and supergroup facilities available to the public at reasonable prices. Western Union recognizes that its proposal raises certain technical questions and asks that the Commission provide for supplemental comments on any such questions.

DISCUSSION

6. Turning first to AT&T's petition, we are unpersuaded by AT&T's arguments to reconsider the requirement that "[t]he interexchange portion of the service . . . be filed under a general rate schedule applicable to all users, whether involving full carrier system or wideband service." Order, para. 28 (footnote omitted). As we stated in our Order, these services all involve use of common plant elements in the same way. They differ only in the selection of other rate elements that are bundled with the underlying transmission capacity.[9] We were concerned, therefore, that there be rate consistency between these services with respect to the underlying transmission capacity, and our requirement of a generally applicable rate schedule addresses that concern.

7. The Commission has expressed concern with consistency in ratemaking on many occasions.[10] Historically, AT&T has charged widely divergent rates for equivalent transmission facilities. As just one example, in *American Telephone and Telegraph Company (Private Line Rate Structure and Volume Discount Practices)* we note that AT&T charged seven different rates, differing by a factor of

[9] Order, paras. 19–20.

[10] *See* Third Report and Order in CC Docket No. 78–72 (Access charge Order), FCC 82–579, para. 51 (released February 28, 1983); American Telephone and Telegraph Company (Bell Packet Switching Service), 91 FCC 2d 1, 16–17 (1982); American Telephone and Telegraph Company (Facilities for Other Common Carriers), 92 FCC 2d 896, para. 15 (1982); and American Telephone and Telegraph Company (Private Line Rate Structure and Volume Discount Practices), 74 FCC 2d 226 (1979).

more than ten, for nominal 4 kHz voice-grade channels of typical length.[11] Similarly, there have been major discrepancies in the pricing of the various services which now use or have in the past used group and supergroup facilities: Series 8000 service in Tariff No. 260, 230.4 kbps services in Tariff No. 258, the Western Union group-supergroup facility contracts terminated in October 1978, specially constructed channels in Tariff No. 265, and voice-grade channels under the MPL rate schedule. Our requirement of a generally applicable rate schedule for group and supergroup interexchange channels was designed to assure that all customers are charged the same rates for the same transmission facilities, irrespective of what packaged service offering they are using.[12] As we noted in our Order, the frequency division multiplex (FDM) hierarchy in AT&T's transmission plant creates a continuum of fixed interrelations between standard channels of lower (e.g., 4 kHz) and higher (e.g., 240 kHz) bandwidth capacity. Order, paras. 2–3. Rate correlations reflecting actual engineering functions should exist as well. Moreover, if we were to allow AT&T to aggregate or bundle facilities and equipment differently in different services or to label them differently according to their intended use, the identity of the group or supergroup channel would be lost and rate comparisons would be difficult, if not impossible, to make.

8. Our Order did not deal at any length with the mechanics of rate development. We pointed out, however, that one readily available source of rates for a common rate schedule is existing rates for those private line services which can be unbundled down to a common core of group and supergroup channels.[13] Such an unbundling process would insure a reasonable degree of comparability among rates for services which use the same or comparable facilities. Establishing consistency among voice-grade (4 kHz), group (48 kHz) and supergroup (240 kHz) rates, essentially based on respective analog bandwidths, would be a significant step toward the elimination of discrimination and the achievement of cost based rates.

9. In requesting that we reconsider our single rate schedule requirement, AT&T argues first that unbundling existing rates for its 230.4 kbps service in Tariff No. 258 to isolate the interexchange channel rate should not be required. AT&T claims that demand for

[11] 74 FCC 2d at 260 (1979).

[12] See, e.g., American Telephone and Telegraph Company (Provision of Services to R.R. Donnelly and Sons Company), Mimeo No. 2364, released Feb. 24, 1982, and American Telephone and Telegraph Company (PICTUREPHONE (R) Meeting Service), 89 FCC 2d 1017 (1982) as illustrative of the Commission's policy that equal charges be made for the same underlying service functions regardless of the specific service category in which these functions are contained.

[13] Order, para. 7. If, for example, the rate for a 56 kbps private line channel which used a 48 kHz group and modems to achieve the 56 kbps bit rate were unbundled, it would include separate rates for the 48 kHz group, the modems and the associated functions.

the service is light and that the interexchange channel used in connection with it is not separately identifiable. The rates, however, for 230.4 kbps service were originally based on rates previously shown in the Series 5000 (Telpak) section of AT&T Tariff No. 260. On the termination of Telpak, these rates were transferred directly to Tariff No. 258.[14] The equivalent supergroup interexchange channel charge, referred to as "base capacity" in the Telpak tariff, was that for a Type 5700 (Telpak C) channel (approximately $35/mile/month).[15] In addition to the channel charge, a service terminal charge applied (*e.g.*, Type 5751 or 5756 at approximately $860 or $760/ per month, respectively), plus charges for add-on features such as synchronization devices.[16] Although these Telpak rate elements lost their individual identities when the total monthly charges were aggregated into a single summary total for purposes of the Tariff No. 258 filing, we see no reason why the individual rate elements, including a rate for the interexchange channel, cannot be reconstructed. Similarly, as we described in the Order (paras. 18–20), the interexchange channel under Series 8000 can be readily separated from the local distribution channels. Thus, we are not persuaded that unbundling of existing rates to isolate the interexchange channel rate element for wideband services is impractical.

10. AT&T's second argument is that even if the existing wideband service rates were unbundled to isolate the interexchange channel rate, that rate would include certain wideband service functions such as special conditioning, wideband service bays and digital and analog modems which are not properly includable in a general group/supergroup rate schedule. In order to unbundle the interexchange group and supergroup transmission services from that interexchange channel rate, therefore, the wideband service functions would have to be unbundled from the interexchange channel rate element. AT&T states that this process would be time consuming. Although we have difficulty understanding why a great deal of time would be required, even if it did, this fact alone would

[14] Telpak was terminated in May 1981. In connection with the termination of Telpak, AT&T filed Transmittal No. 13553, dated September 22, 1980, to "add to AT&T Tariff F.C.C. No. 258 service provisions presently contained in AT&T Tariff F.C.C. No. 260 Series 5000 (Telpak) . . . . The rates for this 230.4 kbps service would be maintained at existing rate levels."

[15] This $35/mile/month charge applied to a supergroup (240 kHz) channel which is the equivalent of 60 voice-grade channels. This is equivalent, in turn, to five group (48 kHz) channels. A comparison of this Telpak-based rate and the Series 12000 (group/supergroup) rates recently filed by AT&T (effective June 15, 1983), however, reveals substantial discrepancies; *e.g.*, a 25 mile group channel under the new Series 12000 rate schedule would cost nearly three times as much as an equivalent group channel under the old Telpak rates.

[16] The original customer service order information associated with individual private line services provides a ready source of information as to which rate elements were specifically involved in these services.

not outweigh the desirability of achieving uniform group and supergroup rates under a rate schedule applicable to all services using the channels. Bundling of the type AT&T has described has been a major impediment to the assessment of the reasonableness of rates for AT&T's various services. See notes 10 and 11, *supra*. Furthermore, although modems and special conditioning are bundled into the interexchange channel rates for wideband and other services (see, *e.g.*, Series 4000 channels in AT&T's Tariff F.C.C. No. 260), they are expressed separately in other cases.[17] Since these elements are stated separately for some services, we see no reason why they can not be separately stated for all. Indeed, they should be separately stated for all in the interest of tariff consistency and ratemaking accountability.

11. AT&T's final argument in opposition to our directive to file a single group/supergroup rate schedule is that the Commission incorrectly assumed that the interexchange facilities used for wideband services are the same as those used for groups and supergroups. On the contrary, AT&T states, the interexchange channels used for wideband services employ facilities other than groups and supergroups transmitted over L or R carrier systems.[18] According to AT&T, group and supergroup spectrum can only be provided on L and R carrier facilities. By contrast, wideband services can be provided over other channel types such as N carrier, T carrier[19] or VF cable.[20] AT&T's argument, therefore, is that the

[17] See section 3.4 of Tariff No. 260 for a separate listing of channel conditioning options and section 3.3.1 of Tariff No. 271 for a separate listing of modems.

[18] "Carrier systems" are broadband, multi-channel facilities developed to increase efficiency and reduce costs by combining (multiplexing) a large number of message signals into a single composite signal. Thus, one carrier channel can be used for many narrower band channels (for voice, data or other signals). A variety of alphabetically designated carrier systems have been developed to meet different transmission system needs (*e.g.* different population densities, different distances). 2 Bell System Center for Technical Education, American Telephone and Telegraph Company, Telecommunications Transmission Engineering, 4–11 (2d ed. 1977).

[19] AT&T states in its petition that T (digital) carrier systems are used in certain cases to provide all or part of interexchange facilities for wideband services. This statement conflicts directly with AT&T's comments in this proceeding. See Comments of AT&T at 10, filed March 2, 1981, which state that a continuous analog spectrum of 1–37 kHz and 1–190 kHz, respectively, exists in group and supergroup-based services. If T carrier were used, such an analog spectrum would not exist in the channel links utilizing the T carrier. Second, since Series 8000 contains the preponderance of all wideband services offered by AT&T, it is reasonable to assume that if T carrier systems are used for wideband services, T carrier systems would be used in association with this service. Yet the tariff at para. 3.2.8 (A)(2) specifically defines a Series 8000 interexchange channel as having a carrier system bandwidth of 48 kHz. This would disallow any use of T carrier.

[20] AT&T asserts that approximately 52 percent of wideband circuits use T carrier, N carrier or VF cable for some part of the interexchange portion of the service. Petition, 5. In addition, AT&T's data indicate that, overall, 97.4 percent of

resulting contamination of "pure" group and supergroup channels provided over L or R carrier systems with services provided over other carrier systems makes it infeasible to include interexchange wideband services in a common rate schedule with group and supergroup services.

12. This argument, however, is based on some incorrect assumptions on AT&T's part. In our Order, we simply stated that the long haul or intercity portion of wideband transmission services utilizes group and supergroup facilities.[21] We did not say that groups and supergroups transmitted over L or R carrier systems constitute the sole means by which wideband signals can be transmitted. Furthermore, the Order was not facility-specific, as AT&T appears to imply. We did not say that group and supergroup channels must be provided over L or R carrier systems, nor was the Order restricted to those group and supergroup channels which are. Rather, we defined these channels in a generic sense by bandwidth, *i.e.*, nominal 48 kHz and 240 kHz bandwidths for groups and supergroups, respectively, without specifying the specific carrier system or systems used to carry those channels and without precluding the possibility that they could traverse other types of higher order channels, *e.g.*, mastergroups,[22] en route to destination.

13. It further appears that AT&T has misunderstood our use of the term "wideband". This term was defined in the Order as a service arrangement which uses analog facilities of the group or supergroup type for the long haul transmission of signals which require broader bandwidth than a 4 kHz voice channel.[23] In addition, AT&T appears to have misunderstood the scope of our requirement. We did not require that all high speed data services be offered on a single tariff based on the group and supergroup rates. Rather, we required that rates for wideband data services which utilize group and supergroup facilities be based on the rates for those facilities. At present, AT&T has a separate tariff rates for those facilities. At present, AT&T has a separate tariff offering for high speed data services offered under the Series 8000 tariff provisions. The Order did not prohibit those distinctions or other reasonable distinctions

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wideband interexchange facilities consist of L or R carrier. Petition, Att. A. These figures, however, cannot be verified based on the data AT&T has supplied. Although AT&T purports to summarize in Attachment A to its petition the "Estimated Interexchange Facility Mix of Series 8000 Wideband Circuits," it does not explain how the data were developed. For example, AT&T does not explain what transmission or service elements constitute the interexchange channels shown in the tabulations. Depending on the elements included, the data submitted by AT&T can take on significantly different meanings. Without proper explanation, therefore, AT&T's data are not subject to reasonable interpretation and are of no persuasive value.

[21] This fact is borne out in AT&T's own tariffs, which, as noted in n. 20, *supra*, describe the interexchange channel of Series 8000 as being 48 kHz in bandwidth.

[22] A mastergroup is equivalent to 600 4 kHz voice grade channels.

[23] Order, para. 3, n. 3.

whihc may be necessary in the future between services offered over group or supergroup facilities and similar services offered over different facilities.

14. With respect to Western Union's petition, our Order did not consider the question of whether entities other than AT&T or the BOCs could provide local distribution facilities for group and supergroup interexchange channels.[24] In ordering AT&T to make group and supergroup service available to OCCs and the public, the Commission did not view as a bar to the general availability of the service AT&T's argument that local distribution problems would be difficult to solve. The Commission directed AT&T to file within six months of release of the Order a statement outlining the steps it has taken to review the feasibility of using existing plant for local distribution of group and supergroup service.[25] As Western Union points out, this function might also be provided by OCCs or other customers if appropriate technical standards were met. As Western Union also points out, however, this proposal raises complex technical issues on which interested persons might wish to comment. We have those issues under consideration and will decide how to proceed with them shortly.

ORDERING CLAUSES

15. Accordingly, IT IS ORDERED that the Petition for Partial Reconsideration filed by American Telephone and Telegraph Company IS DENIED.

16. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 4(j), 201–205, 403 and 404 of the Communications Act, that AT&T shall file tariff revisions in conformity with our orders in this proceeding within thirty days of release of this order, such tariff revisions to be made on forty-five days' notice.

17. IT IS FURTHER ORDERED that the Petition for Amendment of Order filed by Western Union Telegraph Company IS DISMISSED.

18. IT IS FURTHER ORDERED that the Secretary shall cause a copy of this order to be published in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

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[24] The tariff revisions recently filed by AT&T in response to the Order (Transmittal No. 14245) do not, in fact, appear to preclude customers for the Series 12000 group and supergroup channels from providing their own local distribution facilities. *See* American Telephone and Telegraph Company (Group/Supergroup Tariff Order), Mimeo No. 4821, para. 12, n. 9, released June 20, 1983.

[25] Order, para. 28. The Bell Operating Companies filed Comments in response to the Commission's Order on August 15, 1983.

Cellular Mobile Services
Common Carrier, Computer II
Customer Premises Equipment

Divested Bell Operating Companies are required to comply with some of the structural separation conditions of the Computer II rules in offering customer premises equipment and enhanced services after they are divested from American Telephone and Telegraph Company pursuant to the Modified Final Judgment. Also, Bell Operating Companies are required to continue to offer cellular mobile radio services through a cellular separate subsidiary.
–Bell Operating Companies.
CC Docket No. 83–115

FCC 83–552

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies	CC Docket No. 83–115
North American Telephone Association	
Petition for Declaratory Ruling on the Requirement for Sale of Customer Premises Equipment by the Bell Operating Companies	ENF 83–5

REPORT AND ORDER

(Adopted November 23, 1983; Released: December 30, 1983)

BY THE COMMISSION: COMMISSIONER DAWSON CONCURRING IN THE RESULT.

I. *INTRODUCTION*

1. On February 17, 1983, the Commission adopted a Notice of Proposed Rulemaking (Notice), 48 Fed. Reg. 13056 (March 29, 1983), concerning whether the separate subsidiary requirements set forth

in the Computer II decisions[1] and the Cellular Mobile decisions[2] are applicable to the Bell Operating Companies (BOCs)[3] after they are divested by the American Telephone and Telegraph Co. (AT&T) pursuant to the Modification of Final Judgment (MFJ).[4] In our Brief as Amicus Curiae filed in the MFJ proceedings we stated that we did not believe the separation conditions of Computer II would be applicable to the divested BOCs, although we stated that such a requirement could be imposed on them.[5] The North American Telephone Association (NATA) subsequently sought a declaratory ruling that the separate subsidiary requirements of Computer II applied to the divested BOCs.[6] Because we wished to evaluate whether the Cellular and the Computer II separation conditions

[1] Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer II), 77 FCC 2d 384 (1980) (Final Decision), *reconsideration*, 84 FCC 2d 512 (1981), *further reconsideration*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer & Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 103 S.Ct. 2109 (1983).

[2] Cellular Communications Systems (Cellular Order), 86 FCC 2d 469 (1981), *reconsideration*, 89 FCC 2d 58 (Cellular Reconsideration), *further reconsideration*, 90 FCC 2d 571 (1982), *appeal dismissed sub nom.* United States v. FCC, Civ. No. 82–1526 (D.C. Cir., Mar. 3, 1983).

[3] Throughout this order the term BOC is used interchangeably with the term Regional Bell Operating Company (RBOC) unless otherwise noted. Although Cincinnati Bell, Inc. (CBI) and Southern New England Telephone Co. (SNET) are AT&T operating subsidiaries, the MFJ excludes them from the requirement that the operating companies be divested. Therefore, the term BOCs will not be used to refer to CBI or SNET. The Commission has already determined not to require CBI and SNET to structurally separate their unregulated CPE and enhanced services activities from their regulated activities. See In re Motion of Cincinnati Bell Inc. for Declaratory Ruling to Remove Uncertainty of its Status under the Commission Decisions in the Second Computer Inquiry, FCC 83–74 (released February 25, 1983). The seven RBOCs are: NYNEX, which encompasses New England Telephone & Telegraph Co. and New York Telephone Co.; Bell Atlantic, which encompasses Diamond State Telephone Co., Bell Telephone Co. of Pennsylvania, and the Chesapeake & Potomac Telephone Companies; BellSouth, which includes Southern Bell Telephone & Telegraph Co. and South Central Bell Telephone Co.; American Information Technology Corp. (Ameritech), which includes Ohio Bell Telephone Co., Michigan Bell Telephone Co., Indiana Bell Telephone Co., Inc., Illinois Bell Telephone Co. and Wisconsin Telephone Co.; U.S. West, which encompasses Northwestern Bell Telephone Co., Mountain States Telephone & Telegraph Co. and Pacific Northwest Bell Telephone Co.; Southwestern Bell Corp., which includes Southwestern Bell Telephone Co.; and Pacific Telesis Group, which includes Pacific Telephone and Telegraph Co. and Bell Telephone Company of Nevada. A map of the intended geographic boundaries of the RBOCs is in Appendix A to the Notice.

[4] United States v. American Telephone & Telegraph Co., 552 F.Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 103 S.Ct. 1240 (1983). AT&T's application with this Commission for authority to transfer ownership of facilities in accordance with the Plan of Reorganization is currently under review. *See* File No. W-P-C-4955.

[5] Federal Communications Commission Brief on Question No. 2, at 9 n.3 (filed June 14, 1982), United States v. American Telephone & Telegraph Co., 552 F.Supp. 131 (D.D.C. 1982).

[6] NATA's pleading is summarized in Attachment A.*

should be applied to the divested BOCs, we initiated this proceeding and incorporated the NATA petition for declaratory ruling within it.

2. The Notice sought comments from interested parties concerning whether the BOCs' provision of customer premises equipment (CPE) or enhanced services should be conducted only through a separate subsidiary established pursuant to the Computer II rules and whether their offer of cellular services should continue to be conducted through a cellular subsidiary pursuant to the Cellular rules. The Notice identified the four criteria we used in the Computer II decisions to determine whether to impose separate structure on AT&T's provision of CPE and enhanced services: (1) control of bottleneck facilities, (2) opportunity for cross-subsidization, (3) integrated nature of company and (4) ability to enter competitive markets through a separate subsidiary. Parties were asked to analyze the post-divestiture circumstances of the divested BOCs, indicating whether the BOCs met the four criteria. Furthermore, we requested comments with respect to whether modification to the rules is necessary in their application to the RBOCs. Finally, we requested comments on whether there were any enhanced services that the BOCs could provide, given that they were prohibited from offering information services under the MFJ. Comments were filed by numerous parties including the BOCs, equipment manufacturers, enhanced service providers, cellular service providers, federal agencies, and state public utility commissions.[7] Eighteen commenting

[7] Comments were filed by the Associated Bell System Companies (BOCs); Alabama Public Service Commission (Alabama); Association of Data Processing Service Organizations, Inc. (ADAPSO); Associated Telephone Answering Exchanges, Inc. (ATAE); People of the State of California and Public Utilities Commission of the State of California (California); Communications Workers of America (CWA); Computer & Business Equipment Manufacturers Association (CBEMA); Computer & Communications Industry Association (CCIA); Public Service Commission of the District of Columbia (D.C.); Federal Executive Agencies (FEA); Graphic Scanning Corp. (Graphic); Independent Data Communications Manufacturers Association, Inc. (IDCMA); Department of Justice (DOJ); MCI Telecommunications Corp. (MCI); Michigan Public Service Commission Staff (Michigan); National Association of Regulatory Utility Commissioners (NARUC); National Cable Television Association (NCTA); National Telecommunications and Information Administration (NTIA); New York State Department of Public Service (New York); North American Telephone Association (NATA); Pennsylvania Public Utility Commission (Pennsylvania); RCA Cylix Communications Network, Inc. (RCA); Rolm Corp. (Rolm); Satellite Business Systems (SBS); Southern Pacific Communications Co. (SPCC); Tandy Corp. (Tandy); Telocator Network of America (Telocator); Tymnet, Inc. (Tymnet); United Technologies Communications Co. (UTCC); Utelcom, Inc. (Utelcom); Warner Amex Cable Communications Inc. (Warner Amex); and Western Union Telegraph Co. (WU). These comments are summarized in Appendix A. Reply Comments were filed by ATAE; BOCs; California; CCIA; CompuServe, Inc. (CompuServe); CBEMA; Consumers Union (CU); DOJ; FEA; Graphic; IDCMA; MCI; NARUC; NATA: NCTA; NTIA; Rogers U.S. Cablesystems, Inc. (Rogers); Rolm; SPCC; Telocator; and WU. These reply comments are summarized in Appendix B.

parties, including the Department of Justice, favored imposition of some form of structural separation by this Commission; four parties urged the Commission not to require structural separation. State public utility commissions believed that whether to require separate structure should be within their discretion.

3. We conclude in this Order that the benefits to ratepayers and competition which can result from the requirement that CPE, enhanced services and cellular services be offered through a limited form of separation outweigh the costs to the RBOCs of forming and operating through separate subsidiaries. Ratepayers will benefit not only through the reduction of common costs between regulated and unregulated operations, but also by the increased detection of any misallocation of costs between the two operations. In addition, competition should benefit since separate structure can reduce opportunities for anti-competitive conduct. Competition should also benefit since regulatory intrusion into CPE and enhanced services businesses will be significantly reduced because auditing accounting systems is more intrusive than is monitoring compliance with structural separation conditions.

4. We recognize, however, that the BOCs' positions in CPE markets have been significantly changed by the operation of the MFJ. They will reenter CPE markets with virtually no market share. They will no longer be associated with Western Electric and they will not provide interexchange services. Because of these differences between the divested BOCs and pre-divestiture AT&T we do not apply the full panoply of the Computer II rules. Thus, we permit (1) joint billing for CPE for four years following divestiture, (2) the referral of dial tone customers to the separate subsidiary provided that the customer is informed that alternate CPE vendors exist, (3) joint installation and maintenance for residential and single-line business telephones, and (4) the sharing of administrative services. We also permit the BOCs the opportunity to demonstrate that some other organizational structure, such as a separate unincorporated division, will meet the same goals as would a subsidiary. Finally, we have adopted interim procedures to permit the RBOCs to reenter CPE markets without delay, while providing us the opportunity to review capitalization plans. We give the BOCs permission for six months after the divestiture to conduct unregulated operations without structural separation to provide them adequate time to bring themselves into compliance with this order. Our procedures also permit the RBOCs to meet their obligations under the MFJ to provide for the communications needs of national defense and emergency preparedness concerns. Our decision reflects the difficult balancing we must perform. We seek to promote the provision of efficient, reasonably-priced telecommunications services and equipment to consumers. While we apply regulatory constraints on the BOCs so that they are less able to interfere with achievement

of this goal through unreasonable rates or exclusionary conduct, we also look to the BOCs to provide benefits to consumers through their untariffed activities. We may revise our balancing in the future in light of market developments.

A. *Background*

1. *Computer II and Cellular Separation Requirements*

5. In the Computer II decisions, we determined that the provision of CPE and enhanced services would not be regulated under Title II of the Communications Act. In order for common carriers to participate in these unregulated markets, we placed safeguards on a carrier's offering of unregulated CPE and enhanced services to protect ratepayers from absorbing costs incurred by carriers in the provision of CPE and enhanced services and to prevent anticompetitive abuses. A mechanism to meet these goals was the requirement that CPE and enhanced services offerings by carriers should be provided through a separate subsidiary. The Commission determined that only in the case of AT&T did the benefits to be derived from structural separation outweigh the costs imposed in forming and operating through such a subsidiary. Nevertheless, the Commission determined that it might impose the structural separation requirement on other carriers in the future if circumstances warranted. *Final Decision*, 77 FCC 2d 470; *Further Reconsideration*, 88 FCC 2d at 541.

6. In the Cellular Rulemaking we further determined that AT&T should be permitted to offer cellular mobile radio services only through a separate subsidiary, and not through the same subsidiary formed to offer CPE and enhanced services. The cellular separate structure requirement was imposed in order to help assure disclosure to outsiders of arrangements between AT&T's cellular operation and network services operations and to prevent anticompetitive abuses originating from AT&T's dominant control over wireline services, which competitive nonwireline cellular service providers also must access to offer cellular services.[8]

7. The structural separation requirements of the Computer II rules and the cellular rules were adopted at a time when AT&T comprised a nationwide system of both interexchange and local exchange service providers that serviced virtually 100 percent of all interstate telephone users and approximately 80 percent of all local exchange telephone users. AT&T also possessed a significant heads-

[8] The cellular rules, 47 C.F.R. §22.901, are almost identical to the Computer II rules, 47 C.F.R. §64.702. Significantly, however, the cellular rules, unlike the Computer II rules, permit the sharing of computer facilities used for tariffed service by the landline carrier and its cellular subsidiary if the carrier is adequately compensated for the use. Furthermore, unlike the Computer II rules, the Cellular rules permit joint advertising and promotional efforts on behalf of cellular services between the landline carrier and its cellular subsidiary.

tart in the development of cellular services technology. The annual revenues of the Bell System, the largest corporation in the world, were over $65 billion.

2. *Modification of Final Judgment*

8. On January 8, 1982, following the adoption of the Computer II and Cellular rules, AT&T entered an agreement with the Department of Justice to terminate antitrust proceedings. The agreement called for AT&T to divest itself of the BOCs. The Court has approved the spin off of 22 wholly-owned operating companies and their consolidation into seven regional BOCs (RBOCs).[9] The MFJ removes the line-of-business restrictions which were imposed on AT&T as a result of the Consent Decree entered in 1956 between AT&T and the Justice Department. On the other hand, the MFJ imposes line-of-business restrictions on the RBOCs in order to prevent them from utilizing their control of monopoly telecommunications facilities to provide an unfair advantage in competitive markets. The divested BOCs are limited to providing exchange telecommunications, exchange access, information service access, Yellow Pages directory services and CPE.[10] The BOCs may also provide other products and services if the Court approves. The Court stated that the question of whether there should be structural separation between the activities of the RBOCs was a matter for resolution by regulators. 552 F.Supp. at 193 n.251.

9. The seven RBOCs will range in size from $15.1 to $20.8 billion in assets and from 10.3 to 14.2 million network access lines.[11] At least with respect to the provision of exchange telecommunications

[9] The Court approved the MFJ as submitted by the Department of Justice with certain modifications and made its approval expressly subject to the submission by AT&T and Justice of a plan of reorganization to implement the provisions of the MFJ. On April 21, 1983, the Court approved, again with modifications, a plan which established approximately 170 Local Access and Transport Areas (LATAs). After divestiture AT&T would perform interLATA telecommunications, whereas the BOCs would perform intraLATA telecommunications functions. On July 8, 1983, the Court approved with certain altered requirements AT&T's Plan of Reorganization which described how the divestiture was to take place. These plans were finally approved by order dated August 23, 1983, subject to the outcome of a few minor remaining proceedings.

[10] The MFJ prohibits the BOCs from offering "information services." Information services under the MFJ are basically the offering of the capability of generating, storing, transforming or processing or making available information which may be conveyed over the network. It is unclear whether Computer II's definition of enhanced services is equivalent to the MFJ's term information services. The BOCs would be able to offer an enhanced service which is not an information service and which is an exchange telecommunications service, an exchange access service or an information access service. *See* discussion in section II.B., *infra*.

[11] Asset figures are provided in AT&T's Information Statement and Prospectus, filed with the Securities & Exchange Commission (dated November 8, 1983), as of June 30, 1983 as if the asset transfers required by the MFJ had been made on that date. Network access lines are estimated as of January 1, 1984. *Id.*

services, exchange access and information service access, the RBOCs will operate only within their own geographic territories. The MFJ does not prohibit the BOCs from offering CPE outside of the geographic area in which they provide exchange telecommunications services.

10. The Computer II decisions have not barred the BOCs from providing CPE and enhanced services during 1983 through their own separate subsidiaries. Rather, AT&T has made a corporate decision that unregulated CPE and enhanced services would be marketed exclusively by AT&T Information Systems (ATTIS), formerly American Bell Inc. As a result, the BOCs did not provide new CPE after January 1, 1983.[12] The BOCs, however, have been providing embedded CPE[13] and have been supporting this equipment during 1983. At the time of diverstiture, the BOCs must transfer their CPE and related support operations to AT&T, but, pursuant to the MFJ, may then reenter that market.[14]

11. Pursuant to the MFJ, the BOCs will establish a Central Services Organization (CSO). The MFJ requires that the CSO provide a central point of contact for the provision of telecommunications services for national security and emergency preparedness. The RBOCs will each own one-seventh of the stock of the CSO and will pay for the costs incurred by the CSO. Therefore, the CSO will serve as part of the operations of the RBOCs. Nevertheless, despite the fact that the CSO is permitted to provide such support, the BOCs have represented that the CSO will not provide CPE support. The CSO may perform research and development for network operations, plan the network and provide procurement and marketing support to the BOCs in their provision of both exchange telecommunications services and CPE. The CSO may also provide general administrative support for the BOCs, such as financial, accounting, legal, executive and regulatory and legislative affairs assistance. The Court has not

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[12] Certain exceptions exist. For example, the BOCs have been permitted to provide new CPE for disabled customers, *see* American Telephone & Telegraph Co., 92 FCC 2d 1208 (1983), and centrex equipment. *See* Letter from Chief, Common Carrier Bureau to Alfred A. Green, AT&T (July 14, 1983). The BOCs have also been able to provide equipment necessary for the Department of Defense and other federal agencies to meet critical national security and emergency preparedness communications requirements, American Telephone & Telegraph Co., FCC 83–143 (released April 12, 1983), and to provide emergency E-911 equipment. *See* Letter from Chief, Common Carrier Bureau to Alfred A. Green, AT&T (December 30, 1982).

[13] Embedded CPE is that equipment which was subject to the jurisdictional separations and settlements process as of January 1, 1983, which included CPE located on customers' premises or in telephone company inventory as of that date. *See Further Reconsideration*, 88 FCC 2d at 525–26.

[14] The Commission today decided that CPE may be transferred to ATTIS, AT&T's Computer II subsidiary, for provision to the public on a detariffed basis. *See Implementation Proceeding*, CC Docket No. 81–893, FCC 83–551 (adopted November 23, 1983).

limited the ability of the CSO to perform other functions, or to grow or shrink in size, but has made it clear that the CSO should not actually procure products for the BOCs and that both the Court and the Department of Justice would remain alert for anticompetitive conduct by the CSO. *See* July 8 Order, at 139 n.263, 140 n.266. The Plan of Reorganization at page 339 disclosed that the CSO will begin operations with 8800 employees. Of these, 6600 will be technical personnel, and there will be 700 procurement support personnel. The remaining 1500 personnel will be involved in ensuring adequate responses by the RBOCs to national security and emergency preparedness and in providing marketing and other nontechnical management support to the RBOCs.

12. The Plan of Reorganization approved by the Court and AT&T's capitalization plan for the provision of cellular services as approved by this Commission require AT&T to divest its cellular service operations to the BOCs. Each BOC will provide cellular services through individual separate subsidiaries pursuant to the Cellular rules. As noted, the Plan of Reorganization also provides for a separate Cellular Central Staff Organization (CCSO) for the support of cellular services. The CCSO will provide technology oversight capability to ensure that the regional cellular service companies have the ability to provide modern cellular technology. That oversight includes providing support, such as system design, new product and service requirements, technical support for procurement, field support, operating support and cellular technology planning and maintenance. AT&T stated in the Plan of Reorganization that at some time in the future the RBOCs might merge the functions of the CCSO into the CSO.

13. The MFJ, as modified by the Court, gives the RBOCs certain advantages in marketing CPE. In addition, the approved Plan of Reorganization gives the RBOCs certain advantages in providing cellular services. For seven years after the divestiture, the BOCs, in addition to receiving support from the CSO, will have priority access to AT&T, Western Electric and Bell Telephone Laboratories facilities for research, development, manufacturing and other support services to enable them to carry out the provisions of the MFJ. The Court has given the BOCs the right to sublicense Bell System patents not only to other manufacturers of network equipment and services, but also to CPE manufacturers as well.[15] The Court has also granted to the RBOCs the exclusive use of the Bell System logo and other related trademarks.

B. *Issues Before the Commission*

14. In the Notice we invited comment on whether the divested

[15] The Court was careful to note that the right to sublicense patents rested with the individual RBOCs and not with the CSO.

BOCs should be required to form separate subsidiaries in order to provide CPE, enhanced services, and cellular services. Specifically, we invited comment on the following issues:

(a) Whether a divested BOC should be subject to a separate subsidiary requirement for the provision of enhanced services.

(b) Whether a divested BOC should be subject to a separate subsidiary requirement for the provision of CPE.

(c) Whether a divested BOC should be subject to a separate subsidiary requirement for the provision of cellular communications services.

(d) If structural separation is required for the BOC's provision of either enhanced services, CPE, or cellular communications services or all of these, what separation requirements should govern the relationship between the subsidiary and affiliated entities in each case?

Notice at para. 26. The Notice stated that we would consider whether any alterations to the structural separation conditions might be warranted due to the individual circumstances of the divested BOCs.

II. *SEPARATE STRUCTURE*

A. *Policies Underlying Computer II and the Cellular Separation Requirements*

15. We adopted the Computer II rules in order to replace tariff regulation of CPE with market forces and to ensure that ratepayers using AT&T's regulated services did not absorb costs from its unregulated activities. In refusing to regulate enhanced services as common carrier offerings, we found that the marketplace for enhanced services was fully competitive. *Final Decision* at 426. With respect to CPE we concluded that competition was growing and that the Computer II rules contained safeguards which would further the goal of making the CPE market fully competitive. *Id.* at 440-47.

16. Although we determined that market forces would better ensure low-cost, innovative enhanced services and CPE offerings, we recognized that the provision of enhanced services and CPE by AT&T could interfere with proper marketplace functioning. We stated:

> In relying on a structural approach to address our regulatory concerns, the primary benefits of the policy are protection for regulated market ratepayers against costs transferred from the competitive market by the parent corporation, and protection for the general public against such anticompetitive activities as denial of access and predatory pricing.

*Id.*at 463. Requiring separation reduces joint and common costs and places a structural check on the allocation of costs between regulated and unregulated operations. *Id.*at 464. Although accounting has been a fundamental regulatory tool employed by the Commission, it

was never viewed as a substitute for structural separation. "We view separation and accounting as part and parcel of a single regulatory mechanism." *Id.*at 464.

17. We also recognized that, for some carriers, another way to protect ratepayers from overpricing was to require that competitive costs and revenues be placed in separate books of account from those associated with regulated services. We were aware that, absent structural separation, some cross-subsidization could go undetected. We found that structural separation is more effective than accounting separation in protecting ratepayers against improper cost-shifting. In the case of AT&T, we determined that the costs of maintaining separate structure were outweighed by other public interest considerations. *Reconsideration* at 75.

18. Another major goal we sought to achieve in the Computer II decisions was to prevent uncertainty regarding the provision of competitive CPE and enhanced services which could arise if there were a threat that regulation by this or other agencies might inhibit unregulated providers or create impediments to innovation by carriers and others. *Final Decision* at 423, 427. Relying on accounting separation alone may lead to regulatory intrusion because business practices often change swiftly to meet management objectives.

19. In addition, we acted in Computer II to prevent anticompetitive conduct by carriers which could disrupt the development of competitive markets; carriers should not use their control over monopoly network facilities to provide them an unfair advantage in marketing CPE and enhanced services. *Final Decision* at 463–64. We recognized that certain of the Computer II provisions, such as network information disclosure requirements, should be applicable to all carriers to protect the public.

20. In the Cellular rulemaking we were primarily concerned with promoting the use of new cellular communications technology. In establishing a regulatory framework which would promote development and deployment of cellular services we were concerned that a landline carrier's participation in cellular markets could forestall competitors from entering cellular services markets, *Cellular Order* at 493, and that any cross-subsidization, particularly resulting in predatory pricing, be prevented. *Cellular Reconsideration* at 78. We found that "a separate cellular entity greatly simplifies the opportunity of other cellular operators to gain interconnection rights to the landline network on the same basis as the telephone subsidiary offering the underlying basic cellular transmission facilities." *Cellular Order* at 494.

B. *Enhanced Services and Information Services*

21. Prior to determining whether the structural separation conditions are applicable to the divested BOCs' unregulated activi-

ties, we will address the question raised by the Notice with respect to the scope of the activities in which the BOCs may engage. The Notice asked the extent to which the BOCs will be permitted to offer enhanced services consistent with the MFJ's prohibition against the BOCs' offer of information services. It is unclear whether the scope of enhanced services[16] is congruent to that of information services.[17] The Computer II rules permit carriers to offer enhanced services, but not on a regulated basis. On the other hand, the MFJ permits the BOCs only to offer exchange telecommunications services, exchange access, information access, CPE and Yellow Pages directory services. The BOCs are not permitted to provide information services. In analyzing the application of the MFJ to AT&T, the Court noted that enhanced services "are essentially the equivalent of the 'information services' described in the proposed decree . . . ." 552 F.Supp. at 178 n. 198. Despite this apparent conclusion by the Court that the BOCs could not provide enhanced services because those services are equivalent to information services, both the BOCs and DOJ argue in this proceeding that there are some enhanced services which the BOCs may offer.

22. We find in unnecessary to resolve the definitional question at the present time. This is particularly the case since the BOCs have not yet announced which enhanced services, if any, they will offer after divestiture and, consequently, have not stated whether, in their view, such offerings would be permitted under the MFJ. We will assume throughout this opinion that the BOCs may offer some enhanced services. Since we do not regulate enhanced services, the decision is for the Court whether any enhanced services may be offered by the BOCs under the MFJ. The Court will be apprised that any such services the BOCs offer will be subject to the additional safeguards of a separate subsidiary. We shall resolve questions of whether a particular offering by a BOC is an enhanced or basic service on a case-by-case basis.[18] Of course, as we develop more of a

[16] The Computer II rules define enhanced services as follows: "For the purpose of this subpart, the term 'enhanced service' shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. §64.702(a).

[17] "'Information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications, except that such service does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service." MFJ, para. IV.J.

[18] *See, e.g.*, Request of IBM for a Declaratory Ruling, ENF File No. 83–34 (filed June 27, 1983). This request seeks a Commission determination whether Southern Bell Telephone and Telegraph may offer pursuant to tariff Local Area Data Transport

record on potential BOC enhanced service offerings we will be prepared to refine our separation requirements to be no broader than are necessary to accomplish our policy objectives of assuring unencumbered and nondiscriminatory availability of basic transmission services, fair dealing, and safeguards against improper cost-shifting.

C. *Costs and Benefits of Requiring Formation of a Separate Organization*

23. In Computer II the Commission discussed four criteria useful in determining whether a carrier should be required to offer CPE and enhanced services through a separate subsidiary rather than only to maintain separate books of account:

> (a) a carrier's ability to engage in anticompetitive activity through control over "bottleneck" facilities, i.e., local exchange and toll transmission facilities, on a broad national geographic basis; (b) a carrier's ability to engage in cross-subsidization to the detriment of the communications ratepayer; (c) the integrated nature of the carrier and affiliated entities, with special emphasis upon research and development and manufacturing capabilities that are used in conjunction with, or are supported by, communications derived revenues; and (d) the carrier's possession of sufficient resources to enter the competitive market through a separate subsidiary.

Reconsideration at 72.

24. We determined in the Cellular proceeding that only AT&T should form a separate subsidiary. In relieving other wireline carriers from the structural separation conditions, we stated:

> In determining whether a particular carrier should be required to operate through a separate subsidiary, the decision must be based, to the extent possible, on how such a requirement will affect the likelihood that the carrier would otherwise engage in the practices that the requirement is designed to guard against and the ability of the carrier to withstand the costs associated with the requirement.

Cellular Reconsideration at 79. Our determination weighed the costs and benefits of the separate subsidiary requirement. In the following sections, we evaluate the benefits and costs of requiring the BOCs and the CSO to utilize separate subsidiaries for CPE distribution, enhanced services and cellular services.

Service. With respect to enhanced services which involve code and protocol conversion, we are prepared to be flexible. Specifically, we shall follow the waiver procedures outlined in Communications Protocols under Section 64.702 of the Commission's Rules and Regulations, Gen. Docket 80–756, FCC 83–510 (released November 21, 1983), Customs Calling II, 88 FCC 2d 1, 6 (1981), and the *Reconsideration*, 84 FCC 2d at 58.

1. *Benefits to Ratepayers*

25. The question to be addressed here is whether there is potential for cross-subsidization and, if so, whether accounting separation alone will adequately protect against that cross-subsidization. The BOCs argue that the opportunities for cross-subsidization will be minimized because state regulators will assure that monopoly revenues are not used to subsidize competitive offerings. They argue that accounting separation alone will prevent cross-subsidization. They also argue that the number of activities which will produce opportunities for cross-subsidy are limited to retail sales, service operations and administrative costs, which will entail only small costs not justifying the stricter requirement of structural separation.

26. NATA and IDCMA, among others, contend that significant opportunities for cross-subsidization will continue after divestiture. Rolm states that these opportunities will entail substantial costs when compared to competitive CPE providers' revenues. Consumers Union argues that this Commission has recognized in the past the inadequacies of accounting in detecting and preventing cross-subsidization. Both DOJ and ADAPSO argue that joint marketing, installation, maintenance, research and development and general administrative activities will create opportunities for the BOCs improperly to shift costs to the regulated side of operations.

27. The Department of Justice correctly points out in its comments that a limited definition of cross-subsidization, where competitive costs are subsidized with monopoly revenues to reduce the price charged for competitive products, is not the only type of cost-shifting with which we should be concerned. In Computer II we were also concerned with other detrimental cost-shifting arrangements, which include situations where costs that are common to regulated and unregulated operations, such as where the same personnel market regulated and unregulated products and services, are improperly allocated between regulated and unregulated operations. A further problem arises where all costs of an activity should be billed to unregulated operations, such as advertising for specific unregulated products or services. All of these cost-shifting techniques are of concern to the Commission in fulfilling its duty to protect ratepayers from overcharges. Whenever the term cross-subsidization is used in this order it is intended to refer to all cost-shifting situations.

28. We find that, if the RBOCs are permitted to market CPE, cellular services or enhanced services on an unseparated basis, there are opportunities to engage in cross-subsidization. The BOCs have argued that cross-subsidization will be less likely after divestiture than it was before because they will own no manufacturing facilities. The BOCs are correct that the absence of manufacturing facilities reduces the opportunities to cross-subsidize. In addition, state

commissions can be expected to control, to a certain extent, the potential for cross-subsidization through regulation of rates for basic services. Nevertheless, potential cross-subsidization opportunities would exist which could adversely affect ratepayers of regulated services. For instance, if joint marketing were permitted, the personnel who contact customers to market regulated services could be selling CPE and enhanced services at the same time. Difficult, sometimes impossible, problems of fairly allocating the costs of marketing between regulated and unregulated accounts would again occur.

29. Also, if the same technicians who perform installation and maintenance of network facilities are also installing and maintaining CPE, additional allocation problems could occur. Especially if the customer experiences trouble both on the network side of the demarcation point and on the CPE side, accurate allocation of the relative costs between regulated and unregulated accounts may well be impossible. Another miscosting situation could arise if billing, service order entry, or other operational systems were shared between regulated and unregulated operations. It would be difficult to allocate properly the costs associated with these operational systems because the functions performed for and time spent on each type of regulated and unregulated service would not always be comparable.

30. Separation of enhanced services costs could create similar problems if they were offered on an unseparated basis. The provision of enhanced services could entail reliance on the same marketing, installation and maintenance, and operations support organizations that the provision of CPE would. There would be opportunities to place service enhancing software and equipment within the network. Identifying these costs would be very difficult. Furthermore, allowing excess network computer capacity to be used for enhanced services could burden ratepayers. *See Final Decision* at 478–79. On the other hand, we recognize that not permitting enhanced services to be provided as part of the basic network creates inefficiencies. The Commission acknowledged this in Computer II, but determined that these inefficiencies should be tolerated in light of the public interest benefits which could be derived from compliance with separation conditions. *But see* Section II.B., *supra*.

31. We believe the RBOCs will have the incentive, and should have some ability absent separation, to engage in cross-subsidization to the detriment of ratepayers for regulated services. Shifting costs from unregulated to regulated activities may inflate the revenue requirement for regulated services and lead to higher rates for those services. This type of cross-subsidy allows the RBOCs to increase their profits from competitive activities at any level of prices for those products and services. Yet, if the cross-subsidies go undetected,

they do not impair the RBOCs' profits from regulated activities and, thereby, increase their overall profits.

32. As we have stated previously, accounting alone cannot provide the public as much protection against improper cost-shifting as structural separation can. With separate structure, the existence of joint and common operations is limited, reducing the opportunities to shift costs. In addition, separate structure increases the detectability of any cross-subsidization which does occur.

33. The BOCs contend that their integration of operations will be significantly reduced following divestiture since they may not own or control manufacturing or interLATA facilities. They argue that the absence of these operations will reduce the opportunities for cross-subsidization. They state that there are no present plans to perform research and development for CPE by the CSO. NATA, on the other hand, argues that the operation of the CSO provides the greatest opportunity for cross-subsidization.

34. The state public utility commissions which filed comments in this proceeding argue that the FCC should leave to state commissions the decision whether to impose separate structure on the BOC's offer of unregulated products and services. They argue that the states, due to their experience regulating BOCs, will be in the best position to determine the necessity and required operations of a separate subsidiary. Although there is some merit to the states' position, we conclude that leaving the determination to state commissions has a significant potential for disrupting competitive provision of products and services. The RBOCs will operate on an integrated multistate, regional basis. If some states within an RBOCs' area of operation require separate structure and others do not, this could confuse BOC business procedures and compound the states' problems in controlling improper cost-shifting. Those difficulties could exist even if all states required separate structure but with different conditions.

35. What is more, this Commission has an interest in preventing RBOC cross-subsidies since significant cross-subsidization may hinder the goal of cost-based access charges for interexchange carrier interconnection with local exchange facilities. Therefore, we do not follow the suggestion that state commissions be left with the discretion whether to require separate subsidiaries. Our action herein to apply separate structure to the divested BOCs forecloses to the states the option to increase or decrease the separation conditions imposed in this Order.

36. We agree with the BOCs that the absence of manufacturing and interLATA facilities reduces the opportunities for cross-subsidization and the potential for anticompetitive conduct. Nonetheless, the MFJ permits the RBOCs to perform research and development not only for their regulated services but also for permissible enhanced services and CPE as well. July 8 Opinion at 140 n.266. The

CSO may conduct such research and development as well. Clearly, there is nothing in the Computer II rules which would preclude joint research and development as long as this joint research and development does not involve nongeneric software. 47 C.F.R. §64.702(c)(4). If research and development activities for regulated equipment or services become integrated with research for unregulated activities, there may be opportunities for cost-shifting. The Computer II rules should facilitate the control of these costs by requiring the separate organization to enter a written agreement, which should be filed with this Commission, and which states terms sufficiently specific that this Commission can determine whether the agreement provides for adequate compensation.

37. With cellular services, as with unregulated products and services, the cellular central staff will provide an integrating circumstance which will increase the opportunities for cross-subsidization. The CCSO, as it is presently contemplated, will provide a significant variety of functions in support of the BOCs' cellular services operations, including research and development, procurement support, field and operating support, and planning and maintenance functions. These activities are currently anticipated to be provided separate from CSO network operations. The BOCs, however, have represented that they may merge the CCSO with the CSO. If such a merger were to occur, additional opportunities for cross-subsidization may arise. If a merger were to occur, we can address issues related to the merger at that time.

2. *Benefits to Competition*

38. As we recognized in Computer II, promoting competition is also beneficial to customers of unregulated CPE and enhanced services insofar as they are used in conjunction with the basic transmission network. The BOCs argue that they will control bottleneck facilities only in limited geographic territories. They assert that other mechanisms, such as the Commission's Part 68 registration program and the MFJ's equal access requirements, will ensure that the BOCs may not effectively use control over bottleneck facilities to disadvantage competitive providers of CPE and enhanced services. The BOCs also assert that since they will control the actions of the CSO, there will be no national control of bottleneck facilities.

39. DOJ and Rolm argue, on the other hand, that the BOCs will have concentrated bottleneck control in large geographic regions. They point out that the BOCs will have bottleneck control in nearly all metropolitan areas, the major markets for most CPE and enhanced services. NATA, as well as other parties, put forward a statistical showing that each of the RBOCs has within its operating territory a much greater portion of PBXs and telephone sets than even the largest of the independents, GTE. NATA Comments at 12–20. In addition, DOJ argues that it is local, rather than national,

control of bottleneck facilities which should govern our decision whether to impose structural separation.

40. Our review of the relevant facts shows that the RBOCs will control substantial local exchange and intrastate-intraLATA facilities in large geographic regions. Each RBOC will serve from 20 to 30 million people within its territory. These figures represent from 70 to 92 percent of the population in the states in which the RBOCs will operate. In addition, the RBOCs will control from 9.7 million to 13.9 million access lines in their respective territories. We agree with the BOCs that NATA's reliance on pre-divestiture statistics with respect to the number of PBXs and telephones in areas served by the BOCs is misleading since the BOCs will be stripped of their embedded base holdings upon divestiture. Nonetheless, these figures do demonstrate the numbers and types of customers which will be served by the BOCs after divestiture.

41. The BOCs argue that in the *Reconsideration Order* the Commission found that nationwide control of bottleneck facilities was necessary to impose separate structure. It is true that, in the context of deciding whether to impose the structural separation conditions in the Computer II decisions, we did identify that nationwide control of bottleneck facilities was a circumstance which characterized AT&T. Nevertheless, we did not mean to imply that nationwide control was a prerequisite to employing separate structure as a condition on other carriers' offer of CPE or enhanced services. Bottleneck facility control in a broad geographic area can raise sufficient interest in the benefits to competition from structural separation.[19] Indeed, we recognized this in our ruling which relieved Cincinnati Bell and Southern New England Telephone Co. from the separation conditions. *See In re Motion of Cincinnati Bell Inc. for Declaratory Ruling to Remove Uncertainty of its Status and the Commission Decisions in the Second Computer Inquiry*, FCC 83–74 (released February 25, 1983).

42. As the Notice made clear, even with effective bottleneck control on a broad geographic basis, such control would be unimportant by itself if the ability and incentives to use those facilities to engage in anticompetitive activities were not sufficient to cause substantial concern. It is true that the BOCs' ability to do so is somewhat curtailed by current regulations. The Commission's policies as enforced through tariff regulation, the complaint process and its Part 68 registration program require that carriers permit

[19] Under antitrust analysis, a firm's market power is determined in a relevant market, which is the geographic territory of effective competition. A finding of anticompetitive conduct can be sustained if a firm markets products in an area which is less than nationwide. *See, e.g.*, United States v. Griffith, 334 U.S. 100 (1948); United States v. Yellow Cab Co., 332 U.S. 218 (1947); Case-Swayne Co. v. Sunkist Growers, Inc., 369 F.2d 449 (9th Cir. 1966), *cert. denied*, 387 U.S. 932 (1967).

registered CPE to be connected to the network. In addition, the network proprietary information disclosure rule of Computer II, section 64.702(d)(2), inhibits any carrier's ability to prevent access to technical information if it designed the network to favor only its own CPE. Finally, the MFJ's equal access requirements for the BOCs also serve to prevent denial of access to the network to any competing enhanced service provider upon request.

43. Although these three provisions do promote equal access to the network, there may be additional, substantial benefits to competition from the BOCs' entry into unregulated markets through separation. The Commission's Part 68 registration program was in existence when structural separation was imposed on AT&T. Similarly, the network disclosure requirements were adopted as part of the Computer II decisions. Adoption of structural separation in addition to these measures reflects our belief that these measures are not sufficient to ensure fair competition. For instance, structural separation strengthens the network disclosure requirement by making any improper disclosure from regulated to unregulated operations easier to detect. Also, these provisions do not prevent all of the types of anti-competitive abuses which might be prevented through the application of separate structure. For instance, ready access to customer proprietary information, which is not controlled by Part 68 or network disclosure requirements, may provide the carrier's competitive operations with an unfair advantage in marketing unregulated products and services. In addition, none of these provisions does anything to control improper cost-shifting, an important goal of the structural separation conditions. *See* section III.B.1., *supra*. Finally, it is significant to note that under the MFJ, the BOCs are obliged to provide equal access to interexchange and information service providers, but are not required to provide equal access for CPE obtained from BOC competitors. The MFJ's equal access requirement also does not require that the BOCs provide access to others which is equal to the access they provide their own operations. Rather it requires only that other entities be accorded equal access among themselves. Thus, the BOCs, under the MFJ, could provide superior access to the network to themselves to the disadvantage of other CPE or enhanced service providers.

44. In Computer II, it was AT&T's widespread control over local exchange and toll facilities that led the Commission to decide that separate structure should be imposed. *Final Decision* at 468. In fact, the types of potential abuses in which the BOCs may engage are some of the same types of anticompetitive practices which were of concern when structural separation was imposed on AT&T. It is true that the BOCs will reenter CPE markets with a zero percent market share since the MFJ requires BOC CPE to be transferred to AT&T. In addition, CPE markets have become increasingly competitive. Nevertheless, even though the BOCs will be entering increasingly

competitive CPE markets with little installed base, we find that the potential for use of control of monopoly bottleneck facilities is significant enough at present to require some form of structural separation.

45. Control over local exchange services provides an opportunity for anticompetitive conduct. A carrier could use its position as a supplier of exchange services to promote its own CPE or inhibit the use of a third party's CPE; it could through its control of installation and maintenance forces for network facilities provide discriminatorily superior installation and maintenance services for customers of its own CPE. Another competitive danger might arise if BOC regulated operations conditioned the availability of transmission services upon the purchase or lease of RBOC CPE or enhanced services. Such a tie-in could raise entry barriers in the CPE market and inhibit competition. It should be noted that we are not only concerned with actual tie-ins which might violate antitrust laws, but also with more subtle arrangements, such as those described above, which achieve the same result as a tie-in.

46. Furthermore, a BOC could design or alter network technical specifications to favor its own CPE or enhanced services. Although design changes must be disclosed under Computer II to competitiors even by those carriers which are not required to form separate subsidiaries, the existence of structural separation makes more enforceable the early revelation to competitors of these technical changes. In addition, equal access to the network is more easily enforced with separation conditions since the separate organization must obtain network transmission facilities pursuant to tariff. If unseparated operations were permitted, it would be easier for the BOCs to withhold a basic transmission service by offering it only as part of an enhanced service. This could prevent enhanced service suppliers from using new transmission technologies until they could obtain redress from this Commission. Even if the BOC did permit a competitor to obtain access to the basic transmission service, whether a competitive service provider is paying the same as the BOC for that service would be very difficult to determine. The structural separation conditions require that the subsidiary obtain the transmission services under tariff, thereby enabling a competitor to know the terms and conditions of obtaining interconnection from the provisions of that tariff.

47. While we recognize that there is uncertainty as to what types of enhanced services may be provided by the RBOCs, the integration of enhanced services with local exchange switches was an important consideration in adopting Computer II. The separate organization requirement should alleviate most concerns about anti-competitive practices by the BOCs against suppliers of enhanced services since the BOCs would enter, if at all, on the same terms and conditions as other suppliers. Anticompetitive conduct directed against enhanced

service providers can be controlled by structural separation in a manner that may not be effective with accounting separation alone. If a BOC's separate entity is required to obtain access to the network in the same fashion as would a competing supplier, the provision of inferior access to a BOC rival would be much easier to detect.[20] In addition, the design of the network to favor the BOC's own enhanced services would be easier to detect since separate structure could help to reveal any illegal information transfers. Accounting controls, of course, would do nothing to detect or remedy this situation.

48. Cellular services are somewhat distinguishable from CPE or enhanced services because cellular services remain subject to regulation at the state level. Nevertheless, the potential for anti-competitive abuse against cellular carriers will also exist after divestiture. Again, due to the BOCs control over local exchange facilities and, hence, control of access to the network, there is the potential that the BOCs could inhibit access on the same terms and conditions to the nonwireline carrier which competes in the same market. This potential is heightened by the BOCs' authority under the cellular separation rules to share local exchange switches with its cellular operations. The separate subsidiary structure serves to highlight arrangements between wireline and cellular operations so that discrimination can be more easily detected and corrected.

49. We find an additional benefit to competition to be the reduction that accompanies structural separation of unnecessary regulatory intrusion into unregulated operations. Accounting separation can often be more difficult to oversee, and can require far more intrusive monitoring efforts than does the monitoring of structural separation conditions. This intrusive regulation decreases certainty in unregulated markets since there would be a threat of regulatory interference. This regulatory interference could also arise when a state commission would have to investigate possible cost-shifting from the unregulated side of unseparated operations to the regulated side in fulfilling its duties to protect ratepayers from unjustified rate increases. Regulatory examination of potential cost-shifting may delay or reverse BOC efforts to design and price unregulated offerings flexibly and quickly in response to competition.

50. Furthermore, the regulatory burdens faced by this agency are also borne in part by carriers who must provide detailed documentation of their procedures to aid the Commission in its

[20] We of course expect that BOC regulated operations will give identical treatment to competitors of the RBOC Computer II organization. Each RBOC shall maintain documentation of its compliance with this equal treatment condition of Computer II in such a form that it may be provided upon request to the Commission. Any unjustified service delays or other impediments to obtaining local service experienced by interconnect companies or enhanced service providers are viewed with disfavor by this Commission.

monitoring efforts. Policing compliance with separation conditions requires only a narrowly defined disclosure of information regarding the business procedures of the separated entity. On the other hand, in order to evaluate compliance with accounting separation, the Commission often must acquire detailed information from carriers on how the company operates and at times must institute operational changes and reporting mechanisms to determine adequately compliance with accounting separation.[21]

51. Some parties argue that unregulated communications offerings can be protected from any anticompetitive abuses through private enforcement of the antitrust laws or enforcement of the MFJ by the Department of Justice. We believe that private and public enforcement of the antitrust laws can achieve complementary goals to this Commission's efforts to monitor compliance with the separation conditions of Computer II and the Cellular rules by the divested BOCs. The Commission serves as a primary and readily accessible forum to remedy anticompetitive abuses. In addition, the prophylactic measure of structural separation has the potential to prevent abuses from occurring in the first place. We note that the Department of Justice argues that the BOCs' history of using their monopoly power to gain leverage in unregulated markets supports its conclusion that separate structure should be required.

52. We find that the BOCs will have effective control over bottleneck facilities in large geographic areas with large numbers of subscribers. In addition, we find that at present the BOCs will continue to have both the ability and incentive to engage in anticompetitive practices after divestiture. Structural separation can go far in ensuring that such anticompetitive practices are limited and, in any event, more easily detectable.

3. *Costs of Forming and Operating through Subsidiaries*

53. The BOCs argue that forming separate subsidiaries entails substantial costs. They assert that, due to the diseconomies of scale which result from operating through a separate subsidiary, they may be unable to operate efficiently in unregulated markets. It is primarily for this reason that the FEA and NTIA argue that separate structure should not be imposed. DOJ, on the other hand, observes that the costs of forming separate subsidiaries will be low since the BOCs will be starting new operations rather than having to disentangle existing regulated businesses to form unregulated ones. CCIA notes that each of the BOCs will be among the top 30 Fortune 500 companies after divestiture. NATA states that smaller compa-

[21] Although state commissions can be expected to be concerned with BOC accounting practices, as they are with all telephone company providers of local exchange services, accounting regulation by state commissions may be hindered on account of the multistate character and size of the RBOCs.

nies than the BOCs have established separate subsidiaries, apparently at reasonable costs.

54. The BOC's position further is grounded on their argument that there are economies of scale in permitting joint operations. With respect to CPE operations we are unaware of significant economies which could be achieved due to the inherently separate nature of CPE and basic network operations. For example, installation and maintenance personnel must have different skills and expertise to install and maintain sophisticated PBX equipment than to repair network facilities. In addition, there is no reason to believe that significant economies would be lost in requiring separate marketing personnel, for in most geographic areas with substantial residential or business CPE sales, there would be ample business to make separate personnel efficient marketers.

55. Joint operations may allow the BOCs to prosper for reasons other than (1) that they provide a price and quality combination for unregulated products and services that is more attractive than what other suppliers provide, or (2) that they have lower costs. The BOCs could employ their monopoly position in network services to promote their own CPE and enhanced services. These activities involve a danger of anticompetitive practices (*e.g.*, delayed service connection for subscribers purchasing a rival's CPE) and cost shifting (*e.g.*, overallocation toward monopoly services of a sales representative marketing both monopoly services and CPE). Certain types of costs from structural separation will be reduced by the provisions discussed in Section IV, *infra*.

56. With respect to financial resources to form cellular subsidiaries, as Telocator and WU point out, these subsidiaries have already been formed and will be divested intact from AT&T Cellular Co. to the BOCs at divestiture. As with unregulated products and services, we must conclude that the BOCs will have the financial resources to operate through cellular separate subsidiaries.

4. *Application of Separate Structure to BOCs.*

57. Some of the parties argue that the BOCs are similar in size and financial strength to GTE and other independent telephone companies, which were exempted from Computer II's structural separation conditions. We must point out that this proceeding is limited to the question of applying structural separation to the BOCs and this question should be decided on the basis of the factual circumstances of the BOCs alone.

58. We believe that the divested BOCs are distinguishable from GTE at the time it was relieved of the structural separation conditions in Computer II and are distinguishable from GTE and other independent telephone companies at the time they were not required to form cellular subsidiaries in our Cellular decisions. As we previously noted, the RBOCs will possess concentrated control

over monopoly bottleneck facilities in large, continguous geographic areas. The RBOCs will own bottleneck facilities in virtually every major and medium-sized metropolitan and industrial area in the country. In contrast, even the largest of the independents, GTE, controls bottleneck facilities in mostly rural, widely scattered areas. Of course, it is in the metropolitan and industrial areas in which the vast majority of CPE and enhanced services market activity will take place. This disparity between the RBOCs' and GTE's potential customer base is demonstated by statistics cited in NATA's comments, in which it points out that every one of the BOCs placed more PBXs and telephones in their respective regions during 1981 than did GTE nationally. This disparity would be much more dramatic if another independent were compared to the RBOCs.

59. In addition, to form a separate organization, any of the independents would have to disentangle their unregulated and cellular operations from their wireline operations. The BOCs do not have nearly the same disentanglement costs since they will be starting anew in their provision of unregulated CPE and enhanced services. What is more, presently before a district court is a consent decree agreed to by GTE and the Department of Justice in settlement of a lawsuit in which Justice attempted to challenge the legality under the antitrust laws of the purchase by GTE of the assets and some stock of Southern Pacific Communications Company. According to the terms of that Decree, GTE would be required to form a separate subsidiary to provide interexchange telecommunications and may also provide CPE through that subsidiary. The separation conditions of the Decree, with some exceptions, appear to resemble those contained in Computer II. That Decree also requires GTE to place the enhanced services operations of GTE Telenet in a separate subsidiary which would resemble that required of the BOCs.[22] Therefore, if that Decree is entered by the court, GTE may be placed on a more equal footing with the RBOCs in any event.

IV. *LIMITATIONS ON SEPARATION CONDITIONS*

60. We have determined that following the planned divestiture the separate structure approach is the most cost-effective regulatory tool to protect ratepayers from bearing the costs of providing competitive products and services and to promote competition. The further question remains whether any of the structural conditions under which the BOCs operate today as part of the integrated Bell System should be modified or eliminated in the post-divestiture environment. At the outset we note that there may be advantages to the BOCs in employing some other form of organizational structure,

[22] *See* United States v. GTE Corp., 1983–2 Trade Cas. ¶50,833, at 56,812–13 (§§IV.A.6 & IV.D.2). *See also*, Competitive Impact Statement filed by the U.S. Department of Justice at 34–39 (May 4, 1983) in United States v. GTE Corp., *supra*.

such as an unincorporated division, rather than a subsidiary. Although the Computer II rules speak in terms of a separate corporation which may provide CPE and enhanced services, other structural arrangements may also be acceptable as long as structural separation conditions are otherwise met. We note that regardless of the structure employed, the RBOCs must comply with the separation conditions contained in the Computer II rules as modified in this order. Therefore, in the context of capitalization plans we will evaluate the propriety of proposed structural arrangements other than a separate subsidiary as long as the RBOC desiring such an arrangement demonstrates that the arrangement is consistent with our Rules and policies and the advantages which would accrue on account of the alternative organizational structure. The RBOC should particularly address how ratepayers can be legally or practically insulated from the financial losses or debts of the entity marketing CPE and enhanced services.[23]

61. Furthermore, the BOCs have proposed that five of the requirements be eliminated. First, the BOCs argue that they should be permitted to share various operational and administrative services between the separate subsidiary and regulated operations. Second, the BOCs argue that the separate subsidiary should be permitted to engage in joint marketing with regulated operations. Third, they argue that the separate subsidiary should be permitted to obtain installation and maintenance services from regulated operations pursuant to contract. Fourth, the BOCs argue that the rule which requires the separate subsidiary to conduct transactions with an affiliated manufacturing entity at arm's length should be eliminated. Fifth, the BOCs request the elimination of the rule which requires capitalization plans for the formation of a separate subsidiary to be presented for Commission approval 180 days prior to the time the separate subsidiary commences operations. We believe that several modifications to the Computer II rules are appropriate in light of the significantly changed circumstances of the BOCs after divestiture. In addition, we intend to review the appropriateness of the separation conditions within two years following the BOCs' compliance with the Computer II structural separation conditions, as modified in this order, in light of prevailing circumstances.

A. *Joint Operational Activities*

62. First, the BOCs request that they be permitted to provide joint services, such as billing, payroll, accounting, legal, personnel recruitment and management, finance, tax, insurance, and pension services. Section 64.702(c)(1) of our Rules specifically prohibits the

[23] Regardless of what organizational structure the RBOC employs for enhanced services, the separate organization is required to obtain basic transmission services pursuant to tariff.

sharing of billing facilities or personnel between the separate subsidiary and regulated operations. The rule against joint billing is grounded in the concern that the costs of providing billing services cannot be properly allocated between unregulated and regulated operations. This allocation difficulty arises because a myriad of activities included in the billing function, e.g., customer inquiries, order-taking, and collection, must be identified and the costs associated with providing these services for CPE and enhanced services must be segregated on some basis. Opportunities for cross-subsidization would thus arise. In addition, the customer data which is needed properly to compute and send bills includes sensitive customer proprietary information which should not be accessed by personnel providing unregulated products and services. *See American Telephone & Telegraph Co.*, ENF File No. 83–38 (released September 2, 1983). In addition, particularly with business customers, the activities surrounding billing, such as bill dispute resolution, are integrally related to promoting a continuing relationship with existing customers. Therefore, if the RBOCs CPE and enhanced services marketing personnel have access to billing records for transmission facilities, they could use this information to the disadvantage of competitors. To permit rapid reentry by the BOCs into CPE markets, however, we do permit joint billing for four years following divestiture.

63. Nevertheless, we believe that an exception to the Computer II joint billing restrictions is in order to prevent customer confusion caused by MFJ. Customers may suffer confusion once their embedded CPE is transferred from the BOCs to ATTIS as required in the *Implementation Proceeding*, while the BOCs may provide new CPE to them, but only through a separate bill. This confusion might be compounded since we have permitted the BOCs to provide billing services to ATTIS for transferred CPE. Regardless, customer confusion after divestiture is likely to persist even if we do not permit the BOCs to bill for ATTIS CPE. Therefore, during this four-year period we will permit the BOCs to send bills to customers which contain charges for CPE provided by the RBOCs' separate organizations. The bill should contain the CPE provider's telephone number for the customer to contact regarding billing problems with CPE charges. BOC operations for regulated service may not provide bill dispute resolution or collection services for CPE charges and all partial payments of bills shall first be applied against charges for transmission services. In addition, a BOC may not terminate transmission service if an RBOC's separate organization cannot collect from a customer. Since a competing CPE provider, such as Sears, Roebuck & Co., may not have transmission service terminated if its customers do not pay their bills, we find no reason to permit an RBOC separate organization to have transmission services terminated either. The term billing services, as used herein, includes only the physical

rendering of the bill to the customer and the receipt of remitted amounts. An RBOC's separate subsidiary may only transfer computer tapes containing information needed by the RBOC's unregulated operations to produce the bill. The separate organizations shall pay for all direct and indirect costs of producing those bills pursuant to Commission-approved contracts which shall describe necessary accounting plans; RBOCs wanting to engage in joint billing must file their plans with this Commission within 60 days of the release of this decision. We will review these contracts to determine whether the charges to the separate organization for the billing services are equivalent to the charges ATTIS pays the BOCs for similar services. This joint billing permission should not be used in any way to market or promote the separate organization's unregulated products and services.

64. Other operational services, however, which are characterized as administrative services, including financial, accounting, and legal services, are of the variety which this Commission has permitted AT&T to share with ATTIS. Like AT&T, however, the RBOCs may share only those administrative services contained in an RBOC's Commission-approved administrative plan. *See* section IV.E., *infra.*

B. *Marketing*

65. The BOCs next argue that there should be no prohibition of joint marketing, subject to appropriate accounting controls. The BOCs argue that, due to their diminished market power after divestiture, they should not be constrained with the joint marketing prohibition. They argue that customers should be able to obtain at one time both network services and CPE. We must reject these arguments, with one exception. The BOCs have failed to identify convincing reasons why accounting controls effectively can be employed to segregate competitive and regulated costs. As stated previously, reliance on accounting systems alone to allocate common costs is often unsatisfactory. By requiring the total separation of marketing forces, including advertising costs in the case of unregulated products and services, we can more effectively ensure that ratepayers do not bear costs which should be borne by the competitive sector.

66. Furthermore, joint marketing may give the BOCs' marketing operations for unregulated products and services an important competitive advantage. Mixing the marketing of network facilities and unregulated products creates the potential for abusues which the Computer II rules sought to prevent, i.e., the monopoly network facility provider's use of monopoly-derived revenues and its monopoly position to gain unfair leverage in unregulated markets. After divestiture, this control over local bottleneck facilities will continue with the RBOCs in a similar fashion as the bottleneck control which existed with AT&T when the separation conditions were first

imposed on AT&T. Nevertheless, we do permit joint marketing for six months after January 1, 1984, to provide the BOCs time to comply with this order.

67. Despite this general prohibition against joint marketing, we find that an exception is warranted to permit BOC operations for regulated services to refer residential and business customers to the RBOC separation organization for CPE, provided that the contact person informs customers that CPE can be obtained from other vendors as well as the separate organization. This exception is warranted because the BOCs will reenter CPE markets with a zero percent market share in an increasingly competitive market. In addition, this referral will serve to reduce the likely customer confusion when they are informed that the transmission service sales force no longer handles CPE. The BOCs should be able to inform customers of the impact of Computer II and the planned divestiture and that there are alternate suppliers of CPE, among which is the RBOC subsidiary. Furthermore, this exception, in the greater context of the structural separation required in this order, poses only limited opportunities for cross-subsidization which will have a de minimis impact on ratepayers.

68. Thus, the customer contact person for network services may state in a neutral fashion that the company does not provide CPE any longer pursuant to an FCC order, but that CPE is provided both by other vendors and its separate operating arm. The contact person may then ask the customer if he or she wishes to be transferred to the separate organization's marketing personnel and complete the transfer of the call if the customer desires. The BOCs shall, however, bill all direct and indirect costs of providing such referrals to the separate organization pursuant to a Commission-approved marketing plan; RBOCs wanting to engage in dial tone referral should file their accounting plans with this Commission within 60 days of the release of this order. Included within these accounting plans should be a description of the proposed operating procedures in connection with these referrals, including the nature and extent of customer contact by network personnel. In addition, we will continue to evaluate the impact upon ratepayers and competition from this referral approach and whether, due to an RBOC's increased market share of some other factor, the referral is no longer warranted. If the referral approach becomes the vehicle for direct marketing of CPE by network personnel or otherwise is abused, *e.g.*, where a competitor's products are derrogated, we will require its termination.[23a]

[23a] Provision of simple telephones for use with party-line service may present special "customization," installation and maintenance problems, *see*, Amendment of Part 68, 92 FCC2d 1, 32–39 (1982). In view of the limited amount of this equipment, its continuing numeric decline, and these special problems, we shall grant the BOCs the flexibility to market such equipment directly from their unseparated operations, provided that proper accounting separation of the costs

C. *Installation and Maintenance Services*

69. The BOCs argue that the separate subsidiary should be able to contract with regulated operations for the provision of engineering, installation and maintenance, and similar services, subject to appropriate accounting controls. Indeed, pursuant to Commission waiver, for the eighteen month period following January 1, 1983, the BOCs have been permitted to provide installation and maintenance services in support of ATTIS complex business CPE pursuant to an accounting plan approved by the Commission.[24] This transitional waiver was granted because the bifurcated approach to deregulating CPE created two classes of equipment, one embedded and regulated, and one new and unregulated. We recognized at that time that it was unnecessarily wasteful to create two installation and maintenance forces to meet that temporary, bifurcated environment.

70. The circumstances which justified our grant of permission to AT&T to share installation and maintenance services for complex business CPE during a transmission period do not apply to the divested BOCs' offer of business CPE. First, the BOCs will not have two sets of CPE, one embedded and one unregulated, since under the terms of the MFJ embedded CPE must be transferred to AT&T. Second, the personnel who have the sophisticated training necessary to maintain and install business CPE need not be the same personnel who perform network installation and maintenance. Thus, we do not believe that the creation of BOC accounting plans similar to the one under which AT&T presently operates would be in the public interest in the present factual circumstances.[25] We reject installation and maintenance sharing because excessive, costly and burdensome regulatory involvement in the operation, plans and day-to-day activities of the carrier would be necessary to audit and monitor the accounting plans necessary for such sharing to take place. Nonetheless, to ease the transition to compliance with the structural conditions enunciated in our rules, as modified by this order, joint installation and maintenance is permitted until June 30, 1984.

71. With respect to installation and maintenance of residential

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of this activity is ensured in the accounting plans to be filed with this Commission. This option may prove particularly appropriate if a given BOC chooses otherwise not to market simple telephone equipment.

[24] AT&T's plan was approved by the Bureau pursuant to delegated authority. *See* letter from Chief, Common Carrier Bureau to Alfred A. Green (July 26, 1982); letter from Chief, Common Carrier Bureau to D.J. Culkin (Aug. 30, 1982); letter from Chief, Common Carrier Bureau to Alfred A. Green (Dec. 16, 1982); letter from Chief, Common Carrier Bureau to D.J. Culkin (Feb. 18, 1983).

[25] The accounting requirements are contained in letters from the Chief, Common Carrier Bureau to Alfred A. Green and D.J. Culkin, dated Dec. 16, 1982 and Feb. 18, 1983, respectively. These require that the same reporting procedures that ATTIS planned to employ for BOC field forces to bill their time spend on installation and maintenance work for ATTIS CPE be used when performing similar work for BOC embedded CPE.

and single line business telephones, however, different considerations may be involved. First, since these products involve simple installation and maintenance procedures, craftspersons for network facilities may be employed to provide support for residential and single-line business telephones. Second, because the installation and maintenance procedures required for residential and single-line business telephones may be more simplified than for complex business CPE there may be fewer costs which need allocating between regulated and unregulated operations. Given these factors, separation of these functions may not be warranted under our cost-benefit analysis. Thus, we will permit, but will not require, the RBOCs' network installation and maintenance operations to provide support under contract to the separate organizations' provisions of residential and single-line business telephones. These contracts, including a description of how costs are to be allocated, must be filed within 60 days of the release of this order and should describe the accounting plans to be established to allocate all direct and indirect costs of providing those services to the CPE organizations.

D. *Arm's Length Bargaining with Manufacturing Affiliate*

72. The BOCs contend we should delete the Computer II requirement that the separate subsidiary deal with an affiliated manufacturer only on an arm's length basis. The MFJ prohibits the BOCs from owning manufacturing facilities and it imposes non-discriminatory procurement obligations on the BOCs. Therefore, immediately after divestiture this rule is of no consequence to the BOCs. If, however, manufacturing operations were permitted by the Court in the future and were placed within the separate subsidiary for CPE and enhanced services or if manufacturing capabilities are procured by the separate organization itself, rather than the regulated operation, by contract or other means, it would appear that, due to reduced opportunities for cross-subsidization and anti-competitive conduct with regard to the offering of regulated transmission services, waiving the restriction might be in order. Presently, there is an insufficient record upon which to waive the manufacturing rule. Since the BOCs will not own manufacturing facilities at present, there is no need to resolve this question at this time. We will resolve this issue if and when the MFJ's manufacturing bar is lifted.

E. *180-Day Filing Requirement for Capitalization Plan*

73. The BOCs request that we waive the requirement that capitalization plans for the forming of separate organizations be filed for Commission approval 180 days prior to the time of formation. Because the time before the scheduled date of divestiture is short, we find that it is appropriate to waive the requirement that they obtain Commission approval of capitalization plans prior to the commencement of unregulated operations. The BOCs should not be delayed

from entering the CPE and enhanced services marketplaces. AT&T decided that ATTIS would be the sole Bell System provider of new CPE and enhanced services, and that the BOCs would not participate in unregulated markets until divestiture. In order that the Commission can review the BOCs' capitalization plans, permit their rapid reentry into the CPE market, and permit the BOCs time to comply with this order, we will permit the BOCs to offer regulated and unregulated products and services without structural separation for six months until June 30, 1984, at which time full compliance with this order should be achieved. All direct and indirect costs associated with providing CPE and enhanced services should be separately accounted for and not charged to ratepayers.

74. Each RBOC shall file an interim capitalization plan for the formation of a separate organization within 30 days of the release of this Order.[26] The RBOCs may commence unregulated operations as of January 1, 1984.[27] Those plans should provide information as to the amount and type of assets and personnel each RBOC will transfer to its separate organization to support its first year of operations; the operational plans which they will institute to ensure compliance with the Computer II rules; and the timetable for full compliance with the Computer II rules, which must be completed within six months of the time interim plans are filed.[28] These plans

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[26] Immediately after the planned divestiture the BOCs will each have a separate subsidiary for the provision of cellular services. The manner in which these subsidiaries have been formed has already been approved by this Commission pursuant to the Cellular Capitalization Plan filed by AT&T. *See* American Telephone & Telegraph Co., FCC 83–126 (released April 15, 1983), *recon. pending, appeal dismissed*, MCI Cellular Telephone Co. v. FCC, No. 83–1158 (D.C. Cir. September 12, 1983). In its plan, AT&T proposed to form AT&T Cellular Co., which would place in subsidiaries the cellular facilities and personnel necessary to provide cellular service and equipment in each of the seven regions comprising the seven RBOCs. AT&T Cellular Co. provides support services to those seven subsidiaries. After divestiture the seven subsidiaries will be divested to the appropriate RBOCs or BOCs. The cellular support staff will form the CCSO. In these circumstances, there is no further reason to require Commission approval of these subsidiaries.

[27] Thus, the RBOCs will be able to begin all operations in furnishing CPE, including submitting bid proposals, procuring products for resale and distributing products as of January 1, 1984. *See* Petition for Reconsideration filed by Ohio Bell Telephone Co., dated July 22, 1983, of Common Carrier Bureau Letter-Order, dated June 28, 1983; Letter from Illinois Bell Telephone Co. to Chief, Common Carrier Bureau, dated June 24, 1983.

[28] In formulating these plans, the RBOCs should be guided by the Computer II decisions and the Commission decisions approving AT&T's four capitalization plans for ATTIS's provisions of unregulated CPE and enhanced services. *See* American Telephone & Telegraph Co., 90 FCC 2d 404 (1982), *recon. granted in part and denied in part*, 91 FCC 2d 578 (1982), *further recon. denied*, FCC 83–424 (released September 20, 1983) (enhanced services capitalization plan); American Telephone & Telegraph Co., 91 FCC 2d 578 (1982), *recon. denied*, FCC 83–424 (released September 20, 1983) (new CPE capitalization plan); American Tele-

will be effective for only the first year of the RBOCs' operations in order that we may have the opportunity to review permanent plans and require modifications if necessary to comport with the Computer II rules or to ensure adequate safeguards for the protection of ratepayers. These plans will identify the methodology to be employed for recording preoperational expenses from August 11, 1982, the date the Court permitted the BOCs to reenter CPE markets, to the date on which full compliance with this order is attained. The plan shall provide that the separate entity will be organized or incorporated as of January 1, 1984. The plan shall also identify the steps each RBOC will take and the timetable for bringing itself into full compliance with the Computer II rules as modified in this order and shall indicate that the separate subsidiary shall have the capability of independent operations within six months of the filing of the interim plan. The deadline for filing initial capitalization plans should not be burdensome since the initial capitalization plan is intended to be only a framework of the capitalization and operations of the RBOC subsidiaries. We note that even AT&T's permanent capitalization plans have been relatively short in length. In addition, we have accorded some information provided by AT&T with respect to financial projections confidential treatment.

75. On or before June 30, 1984, the RBOCs shall file their formal plans for capitalizing the separate organizations to assure that they are capable of independent operations. Those permanent plans shall indicate the RBOCs' compliance with Computer II rules and shall contain any changes which have been required as a result of the staff's review of the RBOCs' initial capitalization plans. Each RBOC should be aware that, if its plan does not comport with Computer II, it will be required either to modify procedures or to terminate the offer of CPE and enhanced services until it is in full compliance with our Rules.[29]

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phone & Telegraph Co., Mimeo No. 1600 (released December 30, 1982) (Picturephone Meeting Service capitalization plan); American Telephone & Telegraph Co., FCC 83–123 (released April 13, 1983) (report and order concerning new CPE capitalization plan re preoperational expenses and structural separation condition compliance); *recon. pending, appeal dismissed*, MCI Cellular Telephone Co. v. FCC, No. 83–1158 (D.C. Cir. September 12, 1983) (cellular services capitalization plan); Procedures for Implementing the Detariffing of Embedded Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), CC Docket 81-893, FCC 83-551 (adopted November 23, 1983) (embedded CPE capitalization plan).

[29] At present it is unclear what products and services the BOCs will offer. The record with respect to where Yellow Pages operations are to be located is incomplete. If Yellow Pages are regulated by state commissions it may be inappropriate to locate those operations within the Computer II subsidiary. Therefore, within sixty days of the release of this order the RBOCs should file with the Commission their description of where Yellow Pages operations will be located in the various states, whether such operations are in any way regulated by the states and whether Yellow Pages revenues are available to offset rates for

76. Different issues are implicated, however, with respect to the separation of regulated and unregulated operations in the CSO. The BOCs have provided us with very little information with respect to the planned operations for the provision of marketing and procurement support for RBOC CPE operations. The BOCs have represented that they will perform no support functions related to CPE. Nevertheless, BOC descriptions of CSO activities have not been explicit and the CSO is empowered to provide such support. Therefore, within sixty days from the release of this Order the RBOCs shall file with the Commission a report describing in detail the planned operation and functions of the CSO, particularly indicating any activities to be provided in support of RBOC CPE or enhanced services businesses, if any, and any services it will provide AT&T and its affiliates, if any. Until this report has been filed, the CSO should not provide support for CPE or enhanced services businesses.[30] This report should not prove burdensome since it is intended to be only a framework of the intended operations. In addition, since the CSO will assume many of the network planning functions that AT&T has performed in the past, the CSO is obliged to disclose network information as required in *Computer & Business Manufacturers Association*, FCC 83–182 (released May 9, 1983).

77. Although we have approved in principle the proposition that there are some services which the BOCs should be permitted to share, a delineation of any specific services must await the filing of

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regulated services. Due to the particular circumstances of the cellular services marketplace, it may be reasonable to allow the BOCs to offer cellular CPE through the cellular subsidiary. The present record, however, is inadequate to resolve this question. Therefore, in the near future, we shall commence a proceeding regarding how cellular CPE should be provided. Pending its outcome however, deregulated cellular CPE may be offered through the Computer II separate subsidiary but not the cellular subsidiary. Tymnet requests that we require the BOCs' to offer Digital Electronic Message Service only through a separate subsidiary. Since this question is beyond the scope of the Notice we decline to consider this question at this time. With respect to other unregulated products and services, it is arguable that all unregulated products and services should be offered through the Computer II subsidiary. This question is currently subject to a Notice of Inquiry with respect to AT&T's offer of unregulated products and services other than CPE and enhanced services. *See* In re Long-Run Regulation of AT&T's Domestic Interstate Services, CC Docket No. 83–1147, FCC 83–482, at ¶144, (released October 27, 1983). After evaluating the comments in that docket, we shall determine what treatment is appropriate in the case of the divested BOCs.

[30] This requirement does not apply to any CPE for which there is a current waiver in effect. In addition, there is no impediment to the CSO providing on an unseparated basis CPE necessary for the Department of Defense and other federal agencies to meet critical national security and emergency preparedness communications requirements. This CPE, however, may not be tariffed. *See* American Telephone & Telegraph Co., FCC 83–143 (released April 12, 1983). Indeed, the RBOCs have the duty under the MFJ to provide through a centralized organization a central point of contact to meet defense and emergency preparedness needs. MFJ, para. I.B.

shared administrative service plans by each of the RBOCs as to the types of services they propose to share with their separate organizations, if any, their operational plans for sharing administrative services, and the accounting plans which they will employ to ensure that all direct and indirect costs incurred in support of the separate entities' operations are billed to the separate organizations.[31] These plans should be filed within 60 days of the release of this Order and should contain information which is similar with regard both to the kinds of services to be shared and the related accounting systems and information which is contained in the plans filed by AT&T for sharing administrative services and approved by this Commission. *See General Departments Order*, 90 FCC 2d 184 (1984); *Shared Services Order*, 92 FCC 2d 676 (1982), *recon. denied*, FCC 83–355 (released July 29, 1983).[32]

78. After these plans have been analyzed by the staff, we shall make a determination whether the extent of sharing and the operation and the accounting plans are appropriate in the circumstances of the individual parties. To the extent that it is feasible to do so, the RBOCs may submit a joint plan for sharing administrative services, although such a joint filing must identify and justify any individual differences in accounting and operational procedures in the various companies included within the plan. After January 1, 1984, the RBOCs may on an interim basis share the same administrative services as AT&T may share provided that unregulated operations are charged with all costs of providing those services. All allocative formulae for distributing joint and common costs between regulated and unregulated operations are subject to modification and true up procedures any time after these procedures are established.

79. We have fashioned these interim procedures in order to

[31] Presently pending, however, is a Petition for Declaratory Ruling filed by IBM seeking to determine whether an offering of Southern Telephone & Telegraph Co., Local Area Data Transport Services, is an enhanced service and, hence, should not be offered pursuant to tariff. See n.18, *supra*. In addition, presently pending before the Commission is a request for waiver filed by Michigan Bell Telephone Co. in order to provide Miss Dig, an enhanced service which permits a caller who wishes to dig into the ground to discover the location of any nearby utility lines. ENF File No. 83–30.

[32] AT&T presently plans to hold separate the CCSO staff for the support of cellular services from that of the CSO. This planned separation should include the use of accounting which is separate from that utilized to collect costs of other CSO operations. Within 60 days of the date of this order the CCSO shall file a description of the separation conditions it plans to adhere to and the accounting plan it proposes to use to hold cellular costs separate from other regulated costs. AT&T states that at some time in the future it may decide to merge the staff of the CCSO with that of the CSO. At least six months prior to the time any such modification is planned to take place, the CSO must present its plans to the Commission describing the merger and identifying where in the CSO the CCSO staff will be transferred and present its plan with respect to how these services are to be provided consistent with the Cellular rules.

provide the RBOCs with sufficient time to organize and make plans to bring themselves into compliance with our Rules. By our order we intend that the RBOCs be provided every opportunity to rapidly reenter CPE markets. Therefore, the RBOCs may pursue regulated and unregulated businesses without structural separation until June 30, 1984. The RBOCs should utilize this six-month period to take any interim steps necessary to comply with this order by June 30. We do require, however, that during this period the BOCs should in a neutral fashion inform every customer to whom it provides CPE that other vendors sell CPE. It would seem that many of the separation conditions in Computer II will be easier to comply with initially, rather than to start unseparated operations and have to split regulated and unregulated functions later. For instance, there appears to be little reason to begin a joint billing system for business CPE. Sales for unregulated products and services will initially be quite small and a number of supporting services can conveniently be performed on a separated basis or obtained through third parties. In addition, joint installation and maintenance appears unnecessary at the outset since installation activity will be quite small, and there exist third parties from whom such services may be obtained. We will not make the decision for the BOCs as to which of these separation conditions with which they will initially comply. Nevertheless, interim sharing must be fully concluded by June 30, 1984.

V. *CONCLUSION AND ORDERING CLAUSES*

80. We have determined in this proceeding that structural separation should be imposed on the divested BOCs in their offering of CPE and enhanced services, although modifications to the Computer II separation conditions have been made to accommodate the particular circumstances of the divested BOCs. It is evident that we will engage in less regulation of the competitive provision of products and services than if we were to rely solely on accounting to prevent improper cost-shifting. We have found that the benefits, in the ability to detect and prevent improper cost-shifting and other anticompetitive practices, outweigh the costs imposed on the BOCs in forming and operating through separate organizations. We have also concluded that the BOCs have failed to demonstrate that most of the separation conditions should not be applied to them at this time. In this order, however, we do adopt interim arrangements so that the BOCs may begin unregulated operations as of January 1, 1984.

81. Accordingly, IT IS ORDERED that pursuant to sections 4(i), 4(j), 201–205, 214, 220, 221 and 403 of the Communications Act of 1934, as amended (47 U.S.C. sections 154 (i), (j), 201–205, 214, 220, 221 and 403), section 553 of the Administrative Procedure Act (5 U.S.C. section 553), and sections 1.411, *et. seq.*, of the Commission's Rules (47 C.F.R. sections 1.411, *et. seq.*), we HEREBY ORDER that the provisions of section 64.702 of the Commission's Rules (47 C.F.R.

section 64.702), are applicable to NYNEX, Atlantic Bell Companies, Bell South, Southwestern Bell, American Information Technology Corp., U.S. West, Pacific Telesis Group and to all successors in interest to those companies as stated herein.

82. IT IS FURTHER ORDERED that the Petition for Declaratory Ruling filed by North American Telephone Association filed November 30, 1982 is GRANTED as described herein.

83. IT IS FURTHER ORDERED that all motions to accept late filed pleadings are hereby GRANTED.

84. IT IS FURTHER ORDERED that NYNEX, Atlantic Bell Companies, Bell South, Southwestern Bell, American Information Technology Corp., U.S. West, and Pacific Telesis Group shall file interim capitalization plans for the formation of separate subsidiaries which comply with the Computer II rules and decisions rendered pursuant to those rules within 30 days of the release of this order if they intend to enter unregulated markets by January 1, 1984 and formal capitalization plans no later than June 30, 1984. The RBOCs should be in compliance with the Computer II rules as modified in this order within six months of the release of this order.

85. IT IS FURTHER ORDERED that if an RBOC wishes to provide billing services for CPE customers pursuant to this order it shall file its accounting plan with the Commission within 60 days of the release of this order.

86. IT IS FURTHER ORDERED that if an RBOC wishes to refer customers to its Computer II subsidiary pursuant to this order it shall file its accounting and operational plan with the Commission within 60 days of the release of this order.

87. IT IS FURTHER ORDERED that if an RBOC wishes to provide installation and maintenance services for residential and single-line business telephones pursuant to this order it shall file its accounting and operational plan with the Commission within 60 days of the release of this order.

88. IT IS FURTHER ORDERED that if an RBOC or the CSO propose to share administrative services between the Computer II subsidiary and other portions of the company, it shall file a shared administrative services plan with the Commission within 60 days of the release of this order.

89. IT IS FURTHER ORDERED that the RBOCs shall file with this Commission within 60 days of the release of this order a report describing the activities of the Central Services Organization as required herein and a report describing Yellow Pages operations as required herein. These two reports may be consolidated into one.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

*Appendices A&B - may be seen in FCC Dockets Branch, 1919 M St, N.W. Washington, D.C. 20554

Declaratory Ruling, Request For Denied
Political Broadcast, Fairness

Petition for declaratory ruling denied. Commission precedent and policy do not support requested ruling. Petitioners failed to demonstrate that *Cullman Broadcasting Co.'s*, 40 FCC 2d 576 (1963), application to political advertisements has greater potential to chill free speech than application of *Nicholas Zapple*, 23 FCC 2d 707 (1970).
–CBS, Inc.

FCC 83–528

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Request of

CBS Inc., Gaylord Broadcasting Company, Metromedia, Inc., and the National Association of Broadcasters
for
Declaratory Ruling

MEMORANDUM OPINION AND ORDER

(Adopted: November 8, 1983; Released: November 17, 1983)

BY THE COMMISSION:

1. The Commission has before it a petition for declaratory ruling, filed August 2, 1982, by CBS Inc., Gaylord Broadcasting Company, Metromedia, Inc., and the National Association of Broadcasters.[1] Petitioners ask the Commission to declare that:

> [W]hen a licensee sells broadcast time for political advertisements by a political party, independent political committee[2] or other supporters of a candidate,

[1] In order to afford interested parties an opportunity to participate, the Commission, by public notice dated August 4, 1982, sought the filing of comments concerning this request by August 27. The date for filing comments was extended by public notice dated August 19 until September 7. See Appendix A for the names of the commenting parties.

[2] The term "independent political committee" does not appear in the Federal Election Campaign Act of 1971, as amended (FECA). 26 U.S.C. 9001 *et seq.* Apparently, the petition's reference is to an "unauthorized committee" that is making "independent expenditures." An "unauthorized committee" is defined as "a political committee which has not been authorized in writing by any candidate to solicit or receive contributions or make expenditures on behalf of such

whether during or outside a campaign period, the *Cullman* doctrine[3] does not apply and, thus, the licensee has no obligation to provide free time to opposing groups.[4] [Footnotes added.]

2. Petitioners contend that the Commission's recent ruling in *National Conservative Political Action Committee*, (*NCPAC*), 89 FCC 2d 626 (1982),[5] has created confusion among broadcasters because it is inconsistent with Commission precedent to the extent that we determined the *Cullman* doctrine may apply to NCPAC's advertisements broadcast outside campaign periods. Petitioners argue that prior to *NCPAC*, the Commission, consistent with Section 315 policy, held the *Cullman* doctrine inapplicable "to the sale of time for political advertising both during and outside campaign periods."[6]

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candidate, or which has been disavowed [by the candidate]. . . ." 11 CFR §100.5(f)(2).

[3] In *Cullman Broadcasting Co.*, 40 FCC 576 (1963), the Commission stated that:

> [W]here the licensee has chosen to broadcast a sponsored program which for the first time presents one side of a controversial issue, has not presented (or does not plan to present) contrasting viewpoints in other programming, and has been unable to obtain paid sponsorship for the appropriate presentation of the opposing viewpoint or viewpoints, he cannot reject a presentation otherwise suitable to the licensee—and *thus leave the public uniformed* —on the ground that he cannot obtain paid sponsorship for that presentation. [*Id.* at 577.]

[4] The petition defines political committee as "a committee designated to advance or oppose candidates for public office." It states that political committee advertising "may support or oppose specific candidates. It may more generally support the candidates or possible candidates of a particular party or oppose a particular incumbent who is likely to be a candidate for reelection." The petition further explains that the requested ruling "would be equally applicable if a supporter of a candidate, other than a political party or independent committee, purchased time to support or oppose a candidacy."

[5] Initially, in *J. Curtis Herge (NCPAC)*, 88 FCC 2d 626 (B/c Bur. 1981), the Broadcast (now Mass Media) Bureau advised the National Conservative Political Action Committee (NCPAC) that its advertisements, when broadcast outside campaign periods, may subject broadcasters to general Fairness Doctrine obligations, including *Cullman*. In a subsequent complaint against 16 broadcast stations, NCPAC reiterated virtually the same arguments previously addressed. In a letter dated December 18, 1982, the Bureau denied the complaint. Thereafter, in the ruling cited by petitioners, the Commission denied (on a consolidated basis) NCPAC's Application for Review of both Bureau rulings. The Commission stated that "the Bureau's determination that NCPAC's advertisements 'outside campaign periods' may trigger *Cullman* obligations is correct and, contrary to NCPAC's interpretation, is consistent with Commission precedent." 89 FCC 2d at 629 (footnote omitted). The Commission also explained that "'campaign periods' cannot commence without the existence of a legally qualified candidate." *Id.* at 629 n.6.

[6] Petitioners assert that in "[a]ddressing the very issue presented by this petition, the Commission held "that *Cullman* was not applicable to the sale of time to political parties outside, as well as during, campaign periods." *Democratic National Committee*, 25 FCC 2d 216 (1970), *aff'd on other grounds sub nom., Columbia Broadcasting System v. Democratic National Committee*, 412 U.S. 94 (1973). Petitioners cited a second case for the proposition that *Zapple* has been applied outside campaign periods. *Republican National Committee*, 25 FCC 2d 739 (1970), *rev'd on other grounds sub nom., Columbia Broadcasting System, v. FCC,*

3. Petitioners state Congress incorporated the Fairness Doctrine into Section 315 to assure in part "that the purpose of Section 315—to prevent discrimination among candidates and subsidization of election campaigns by broadcasters—would not be circumvented by the provision of disproportionate opportunities to candidates' supporters." Thus, it is argued that applying *Cullman* to "political advertising" inside or outside campaign periods thwarts Section 315 policy. Petitioners argue that the Commission's ruling in *Nicholas Zapple*, 23 FCC 2d 707 (1970), supports its request by its rejection of *Cullman* in the "direct political arena."[7] Petitioners state that "[n]othing in the reasoning of *Zapple* suggested that the decision should be limited to campaign periods." Petitioners contend that "there are no clear objective criteria as to when a campaign begins" and even if such criteria existed "there is no logical reason to treat political advertising differently in one period than the other."[8]

4. Lastly, petitioners assert that "application of *Cullman* to paid

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454 F.2d 1018 (D.C. Cir. 1971). In addition, petitioners state that the Commission, in its *First Fairness Report*, 36 FCC 2d 40 (1972), reaffirmed "that *Zapple* applied generally [during and outside campaign periods] to the sale of time to political committees." In this regard, the petition cites the Commission's statement that:

> If the DNC were sold time for a number of spots, it is difficult to conceive on what basis the licensee could then refuse to sell comparable time to the RNC [*Id.* at 49].

[7] In establishing a "quasi-equal opportunity" doctrine for supporters or spokespersons, the Commission in *Zapple* stated:

> Where a spokesman for, or a supporter of candidate A, buys time and broadcasts a discussion of the candidates or the campaign issues, there has clearly been the presentation of one side of a controversial issue of public importance. It is equally clear that spokesmen for or supporters of opposing candidate B are not only appropriate, but the logical spokesmen for presenting contrasting views. Therefore, barring unusual circumstances, it would not be reasonable for a licensee to refuse to sell time to spokesmen for or supporters of candidate B comparable to that previously bought on behalf of candidate A. [*Id.* at 708]

With respect to Cullman's applicability, the Commission in *Zapple* stated:

> While we continue our firm support for this general proposition [*Cullman*], we believe it should not have applicability in the direct political arena. When spokesmen or supporters of candidate A have purchased time, it is our view that it would be inappropriate to require licensees to in effect subsidize the campaign of an opposing candidate by providing candidate B's spokesmen or supporters with free time (e.g., the chairman of the national committee of a major party purchases time to urge the election of his candidate, and his counterpart then requests free time for a program on behalf of his candidate). Any such requirement would be an unwarranted and inappropriate intrusion of the Fairness Doctrine into the area of political campaign financing. [*Id.*; footnote omitted.]

[8] Petitioners argue that:

> In light of the ongoing nature of campaigning by political parties and independent committees, it makes no sense to treat their paid political advertising under the Fairness Doctrine one way outside the campaign period and another during the campaign.

political advertising outside campaign periods undermines important First Amendment interests." In this context, petitioners state that "in defending against complaints under the general Fairness Doctrine and the *Cullman* principle broadcasters may be required to show that contrasting viewpoints were presented." Petitioners believe that removing *Cullman* applicability from the political arena "would avoid the necessity for broadcasters to respond to Fairness Doctrine complaints by attempting to show that the paid political advertising was balanced by the licensee's own journalistic coverage." In addition, petitioners state that "in resolving these complaints the Commission may be required to review broadcaster programming and to make judgments concerning the alleged imbalance." In this respect exclusion of *Cullman* as requested "would avoid intrusive Commission oversight of broadcaster decisions in this sensitive political area and further First Amendment and statutory goals."

Comments

5. NCPAC, the American Legal Foundation, and all broadcast entities commenting on the petition generally agree with petitioners that Commission precedent, Section 315 and First Amendment concerns support a ruling that the *Cullman* doctrine does not apply to the sale of broadcast time to a political party, committee or other supporters, regardless of whether such programming is aired during or outside a campaign period. These parties back petitioners' assertion that the Commission's *NCPAC* ruling, *supra*, represents a departure from its previously consistent approach of rejecting *Cullman* application to the "direct political arena." Specifically, with respect to Commission precedent and its relationship to Section 315, there is a consensus that: (1) the Commission has on two occasions extended *Zapple* to noncampaign periods;[9] (2) the nonsubsidization philosophy behind Section 315 conflicts with *Cullman* being applied to "political" discussion; (3) in *Zapple* the Commission applied Section 315 principles because it recognized the inappropriateness of extending *Cullman* into the area of campaign financing; and (4) the Commission in furtherance of the congressional intention demonstrated by Section 315, with the exception of its *NCPAC* holding, has implemented a regulatory scheme which is designed to avoid broadcaster intrusion and involvement in the political process, which it is argued is no less intrusive outside an official campaign period.

6. In addition to being in conflict with precedent and Section 315, it is argued that application of *Cullman* to political discussion thwarts First Amendment rights by inhibiting broadcasters from accepting advertising outside campaign periods. It is suggested that

[9] *Democratic National Committee*, and *Republican National Committee, supra.*

this "chilling" of fundamental rights, especially in the area of political discussion, requires the requested ruling as a matter of sound administrative policy.[10]

7. Many of the supporting parties agree with petitioners' assertion that no clear objective criteria exists as to when a given campaign commences and that in any event, campaigning is not confined to formal campaign periods. To the contrary, it is urged that the reality of the political process involves campaigning on a continual basis. Moreover, it is argued that the *NCPAC* ruling ignores the recent emergence of "independent" political committees resulting from the FECA and its review by the Supreme Court in *Buckley v. Valeo, supra.* In *Buckley,* the Court, in striking a provision of the FECA which limited independent expenditures, stated that the First Amendment requires that individuals and groups completely indpendent from any candidate be entitled to spend unlimited amounts of money for campaign purposes. It is argued that we properly extended *Zapple* to the major political parties in *Democratic National Committee, supra,* and *Republican National Committee, supra,* because we recognized the continual nature of the major political party's campaign efforts. In this respect, it is asserted that for these same reasons the Commission should limit *Cullman* as requested because there now exists a substantial number of other individuals and independent entities whose participation is likewise not limited to formal campaign periods.

8. Contrasting theories of the appropriate implementation of this request have been submitted. Most parties agree with petitioners that the content of the advertising to the extent that particular candidates are discussed must be considered. However, one party suggests that the content of advertising should not be a factor in applying *Zapple,* but that the sole test for its application should be the nature of the person or group making the initial purchase, regardless of whether particular candidates are mentioned. It is argued that the broadcaster should not be burdened with having to evaluate whether particular speech itself is subject to *Zapple.* In this connection, it is asserted that *Zapple* did not deal with the question of content; rather, it focused on the partisan/political nature of the person or group using the broadcast time.

9. Those commenting parties in opposition generally agree that

[10] In this regard, the following statement from *Buckley v. Valeo,* 424 U.S. 1 (1976) is cited:

> Discussion of public issues and debate on the qualifications of candidates are integral to the operation of the system of government established by our Constitution. The First Amendment affords the broadest protection to such political expression in order "to assure [the] unfettered interchange of ideas for the bringing about of political and social changes desired by the people."

Id. at 14 (quoting *Roth v. United States,* 354 U.S. 476, 484 (1957).)

the effect of the requested ruling would be the potential "gutting" of the Fairness Doctrine. In this context it is argued that individuals or groups wishing to espouse views on an issue to which the *Cullman* doctrine would normally be applicable could avoid its application through the mechanism of a political action committee or merely by indicating their support or opposition to particular candidates, regardless of whether they are legally qualified. It is argued that this would recognize a distinction which has the potential for leaving the public uniformed merely because of the label placed upon the discussion by the individual or group purchasing the broadcast time.

10. Furthermore, because *Zapple* is modeled afer Section 315, it is asserted that it is inconsistent with Congress' intent to apply it outside periods that equal opportunities are required. Several parties believe that viewed within the Section 315 framework, this request could create anomalous situations in which political parties, committees or other supporters of candidates are afforded greater rights than Congress chose to afford the candidates themselves.

11. Those opposed to the petition also argue that the *NCPAC* ruling dispelled confusion and is completely consistent with Commission precedent. Although there is acknowledgment that two cases cited by petitioners involved an apparent extension of *Zapple*, it is argued that in *Democratic National Committee*, *supra*, the Commission extended *Zapple* only to "fundraising" announcements, and not discussion of particular controversial public issues; that the Court of Appeals reversed the Commission's attempt to extend *Zapple* in *Republican National Committee*, *supra*, and; that the Commission clarified its position regarding *Zapple's* inapplicability outside campaign periods in its *First Fairness Report*, *supra*, where the Commission indicated *Zapple's* appropriate application is "confined" to "campaign periods."

12. Several parties argue that petitioners' assertion that "political" discussion requires *Zapple* application is flawed. It is noted in this regard that ballot propositions are clearly within the political arena and are subject to *Cullman* both outside and inside campaign periods.

Reply Comments

13. In its reply, petitioners contend their assertion that identical discussion should not be treated differently based upon its broadcast during or outside formal campaign periods has not been refuted. Further, petitioners assert that rather than "gut" the Fairness Doctrine, their proposal would maintain application of *Cullman* to "nonpolitical material," both during and outside campaign periods. Petitioners also argue that any problems concerning exactly which advertisements their proposed scheme would be subject to can be resolved by the Commission on a "case-by-case basis." Moreover,

they assert that similar definitional problems arise under the Commission's present application of *Zapple*.

14. Petitioners argue that the opposing parties' assertion that *Democratic National Committee, supra*, was limited to "political fundraising spots" is mistaken. In this context, petitioners state "nothing in that ruling suggests that the Commission intended under *Zapple* to distinguish between political fundraising outside campaign periods and other political advertising not purchased during campaign periods."

15. With respect to the Court of Appeals' reversal of *Republican National Committee, supra*, in *CBS v. FCC, supra*, petitioners assert that the court merely overturned that particular application of *Zapple*. The court did not rule that *Zapple* could not be applied outside campaign periods. Further, they note that in *Republican National Committee, supra*the court considered application of *Zapple* to an initial grant of free time, whereas, its requested action is "directed only to paid political advertising." Lastly, petitioners contend that even though *Zapple* is modeled after Section 315, the "*Zapple* doctrine is a corollary of the Fairness Doctrine, which is clearly not limited to campaign periods," and, therefore, "the Commission can implement the policies of Section 315 by applying *Zapple* outside campaign periods even though Section 315 itself is inapplicable."

16. In its reply comments, DNC contends that broadcasters have overlooked the consequences of extending *Zapple* as suggested. It asserts that once the broadcaster sells time to an individual or entity under the circumstances envisioned by petitioners, a chain of contingent access rights will be established which will remove the discretion now possessed by broadcasters to select appropriate spokespersons and determine the format for presentation of contrasting points of view. Further, because so many parties may assert a *Zapple* right to respond to an initial broadcast, the broadcaster and ultimately the Commission may be required to make judgments to which no clear objective standard can be applied. DNC argues, "[o]nly by restricting *Zapple* to candidates and their authorized spokespersons (including political parties) *within election periods* can this quandry be avoided." In this respect DNC supports another commenting party's suggestion that *Zapple* be inapplicable generally to political action committee advertising "whenever aired" inside or outside campaign periods, especially "independent political committees," which by law must be "unauthorized" by any candidate.

17. DNC raises a new question of whether the requested ruling might be unconstitutional. In this respect DNC argues that petitioners' selection of "political" entities for "favored" contingent access rights appears to conflict with the Supreme Court's statement in *CBS v. Democratic National Committee, supra*, that "we see no principled means under the First Amendment of favoring access by

organized political parties over other groups or individuals," *Id.* at 127 n.21. Lastly, DNC argues that any changes in the present regulatory scheme must be made by Congress.

Discussion

18. To implement the Fairness Doctrine, a twofold obligation is required of broadcasters: (1) inform the public by airing discussions on controversial issues of public importance; and (2) afford reasonable opportunity for the presentation of contrasting viewpoints in their overall programming when one side of a particular controversial public issue has been presented. *Fairness Report*, 48 FCC 2d 1 (1974). In *Cullman*, the Commission was asked to clarify its policy with respect to the second prong—the obligation to present contrasting views. The Commission held that a broadcaster's inability to obtain paid sponsorship for the presentation of contrasting viewpoints may not prevent such views from being aired. However, *Cullman* should not be interpreted to mean, as several commentors have suggested, that free spot or program time for presentation of contrasting views is the necessary outcome in every instance. *Cullman* affords some discretion to the broadcaster by specifying that free time is required only when the broadcaster "has not presented (or does not plan to present) contrasting viewpoints in other programming, and is unable to obtain paid sponsorship." This allows the broadcaster to formulate other methods for meeting its obligation to present contrasting points of view, without necessarily having to give away spot or program time to specific individuals or groups.[11]

19. Until the Commission's 1970 ruling in *Zapple*, no exception to the *Cullman* doctrine was recognized. In *Zapple*, the Commission was requested to issue a ruling regarding a broadcaster's appropriate obligation under the Fairness Doctrine to supporters of a legally

[11] The Broadcast Bureau's recent ruling in *Citizens for a Radioactive Waste Policy*, —FCC 2d—(B/c Bur. September 16, 1982), illustrates this point. In that case, the proponents of the "No" side of a ballot proposition were sold 104 30-second spots. The station refused to give free spot time to the "Yes" side. The Bureau, in finding that the station had not violated the Fairness Doctrine, stated:

> Under *Cullman*, a licensee is not necessarily bound to give free broadcast time for spot announcements if it presents appropriate contrasting viewpoints in other programming, so that its audience is not left uninformed on the issue. In addition, it is well settled that your organization has no specific right of access to the station to present its viewpoint. Rather, the licensee has the discretion to determine how best to present contrasting views in its overall programming. *See Columbia Broadcasting System v. Democratic National Committee*, 412 U.S. 94 (1973). Thus, we are not concerned at this point with KYTV's denial of your request for "free" broadcast time. The issue in the instant matter is not whether you or any other individual or group were given time to present contrasting viewpoints, but whether the station's overall programming on the issue adequately informed the public as to the significant contrasting viewpoints on the issue.

qualified candidate when broadcast time is sold to supporters of an opposing candidate for "non-use"[12] spot or program announcements. The Commission addressed two principal issues: (1) In light of the policies inherent in the "equal opportunities" obligations set forth in Section 315 for "uses" by "legally qualified candidates," should the broadcaster be obligated to provide rights similar to equal opportunities to the supporters of opposing candidates; and (2) Because Congress in enacting Section 315 mandated that free time need not be afforded a legally qualified candidate when his or her legally qualified opponent has purchased time, should *Cullman* be applicable? The Commission determined that consistent with Congress' intent to avoid both broadcaster discrimination among legally qualified candidates and subsidization of any particular candidacy, that it must declare a policy which mirrored Section 315's policies. Accordingly, the Commission established a "quasi-equal opportunities" approach with no application of *Cullman* to supporters *during* campaign periods. Commission precedent supports this interpretation. Petitioners argue that nothing in *Zapple* limited its application to campaign periods. Rather, they assert that by rejecting *Cullman* in the "direct political arena" the Commission indicated the general applicability of *Zapple* to "political" discussion. We disagree. Immediately following rejection of *Cullman* in the "direct political arena," the Commission in *Zapple, supra*, stated:

> To implement this view, we would carve out the same area as in the case of our personal attack rules, i.e., there would be no obligation to provide free time to authorized spokesmen of or those associated with *legally qualified candidate* B in a situation such as your point where candidate A, his authorized spokesmen or those associated with him, have purchased time. [*Id.* at 708.] [Emphasis added; footnote omitted.]

Therefore, contrary to petitioners' assertions, the Commission qualified the scope of the "political arena" by explicitly limiting *Zapple's* application to supporters of "legally qualified candidate[s]." Moreover, as we noted in our *Fairness Report, supra*, one of the questions raised in our 1971 Notice of Inquiry into the Fairness Doctrine was: "Should the Commission adopt a position that *Zapple* applies only to

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[12] Section 315(a) provides in pertinent part:

> (a) If any licensee shall permit any person who is a legally qualified candidate for any public office to use a broadcasting station, he shall afford equal opportunities to all other such candidates for that office in the use of such broadcasting station . . .

In general, any broadcast or cablecast of a candidate's voice or picture is a "use" of a station or cable system by the candidate if the candidate's participation in the program or announcement is such that he will be identified by members of the audience. However, Section 315 of the Communications Act lists four types of [news] broadcasts by candidates which are not considered to be uses. *See Charles F. Dykas*, 35 FCC 2d 937 (1972); *Gray Communications Systems, Inc.*, 19 FCC 2d 532 (1969).

political campaigns and not to other times?" After careful consideration of the comments submitted and all other relevant information before it, the Commission stated, contrary to petitioner's assertion that we reaffirmed extension of *Zapple* outside campaign periods, that:

> Thus, the *Zapple* ruling simply reflects the common sense of what the public interest, taking into account underlying Congressional policies in the political broadcast area, requires in campaign situations such as the above (and in view of its nature, the application of *Zapple*, for all practical purposes, is confined to campaign periods). [48 FCC 2d at 43–44.]

Accordingly, in affirming the Bureau's rulings in *NCPAC, supra*, the Commission stated:

> Thus, NCPAC's argument that the content of its advertisements requires that they be treated within the "political arena" outside campaign periods is not supported by the *Fairness Report. Clearly, Zapple rights which are triggered by advertisements which present views directly related to campaign situations have been "confined" to campaign periods. This is consistent with the rights that candidates themselves have.* [89 FCC 2d at 630 n.7, emphasis added.]

20. Nonetheless, it is argued that our limitation of *Zapple's* application to formal "campaign periods" is inconsistent with the two Commission rulings cited in footnote 6 above. We do not believe that either ruling supports this position. *Democratic National Committee, supra*, is cited for the proposition that we extended *Zapple* generally to the major political parties "during noncampaign periods." In that case, the DNC sought a ruling that it should be afforded an *initial* right of access to comment on important issues of the day *and* to solicit funds. While refusing to afford a common-carrier approach for comment on public issues, a determination affirmed by the Supreme Court in *CBS v. Democratic National Committee, supra*, the Commission did support a right of access for "fund solicitation." In this limited respect, because we found such an *initial* right of access in the public interest, we rightfully did not also require that other major political parties should be afforded free time for fund solicitation if the initial solicitation announcements were purchased. Clearly, the *DNC* ruling is limited to a factual setting that is completely distinguishable from the proposed extension of *Zapple* where initial access is not required. The second case, *Republican National Committee, supra*, is also not dispositive. The Commission's attempt there to extend *Zapple* was overturned by the Court of Appeals as "arbitrary and irrational." Further, the case involved an initial grant of free time so that the *Cullman* question was never addressed.

21. Moreover, even in the case of ballot propositions, the Commission has avoided any exception to *Cullman*. Few issues are more subject to being described as "political." Yet the Commission recognized that although propositions are subject to popular vote,

and thus are clearly analagous to candidate campaigns, Congress has shown no inclination for such "political" *issues* to be treated differently. Furthermore, as a practical matter the Commission rejected application of *Zapple* to ballot propositions because, unlike *Zapple's* applicability to supporters of legally qualified candidates, proponents of various points of view are not so easily identified. See *Fairness Report, supra*, at 32. Similarly, without the benefit of the "legally qualified" status that broadcasters may rely upon for meeting their Section 315 and *Zapple* obligations, the proposed approach also lacks the "readily identifiable" characteristic necessary for efficient implementation.

22. Most important, we believe that *Zapple*, as presently applied, is more consistent with Congress' intent to avoid unequal treatment of candidates, not the issues to which each candidate is associated. In the discussion that follows we explain more fully why *Zapple's* limited exception to the general fairness approach is justified by its specific adherence to congressionally stated goals in Section 315.

23. Petitioners contend that their requested ruling would "comport with the purposes of Section 315." In this connection, the petition states:

> Section 315 itself makes clear that free time need not be provided to respond to paid political advertising by candidates. That section simply provides that when broadcast time is sold to a "legally qualified candidate," a comparable opportunity to purchase time must be afforded opposing candidates. Exclusion of the *Cullman* doctrine in such cases is consistent with the central purpose of Section 315 to avoid discrimination among candidates and the subsidization of political campaigns by broadcasters.

Petitioners contend further that such policy considerations led the Commission in *Zapple* to reject "application of the *Cullman* doctrine in the 'direct political arena' based on the policies of Section 315." Their reliance upon Section 315, however, refutes rather than supports their argument.

24. Section 315's explicit limitation to "legally qualified candidates" unequivocally restricts the equal opportunities obligations imposed upon broadcasters to readily identifiable candidates during corresponding campaign periods. Congress intended that broadcasters benefit from being able to ascertain precisely to whom and during what periods Section 315 applies. Thus, the Commission, with the affirmance of the Court of Appeals, stressed with respect to this limitation that:

> This language [legally qualified candidate] makes clear that the Congress in originally adopting this provision in 1934 did not, and did not intend to, accord equal time rights to persons simply because they are referred to in public and press speculation as possible candidates, contenders, or as being in the running. The statute by its express terms limits equal time rights only to contestants who are legally qualified candidates for public office. [*Sen. Eugene J. McCarthy*, 11

FCC 2d 511, 512 (1968), *aff'd sub nom. McCarthy v. FCC*, 390 F.2d 471 (D.C. Cir. 1968.]

Zapple, as petitioners correctly note, is based upon the Commission's desire to avoid circumvention of Section 315 by broadcasters through the disproportionate presentation of supporters' appearances. Clearly, because *Zapple* is intended to prevent this result, it logically is directed at supporters of the "legally qualified candidates" to which Section 315 applies. Any other approach would create the anomalous result of supporters having greater rights than the candidates themselves. In contrast to the present application of *Zapple* during campaign periods, appropriately confined to supporters of readily identifiable and verifiable "legally qualified candidates," petitioners suggest a scheme inherently fraught with confusion and pitfalls.[13] Thus, *Zapple*, consistent with its Section 315 model, is not and should not be made applicable on a speculative basis. Within this framework, if, as petitioners argue "it makes no sense to treat paid political advertising under the Fairness Doctrine one way outside the campaign period and another during," then it follows that Section 315's applicability to appearances by the candidates themselves should also be extended beyond distinct campaign periods. However, it is clear from the language of Section 315 that Congress chose to limit equal opportunity protection to legally qualified and, therefore, identifiable candidates during distinct campaign periods. Accordingly, a determination to extend this approach to either the candidates or the "political" issues of the day is appropriately left to Congress.[14]

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[13] In *McCarthy, supra*, the Commission in addressing these policy considerations stated:

> The policy reason for the above regulation is to bring necessary order to the effectuation of the congressional purpose — to avoid a chaotic situation which would undermine the efficacy of the provision. For example, incumbents often are eligible to run again, and, prior to a determination to seek another term, they may take many preliminary steps of varying nature (e.g., frequent trips to the election State, with speeches, conferences with financial sources, and potential delegates). Many incumbents later bear out previous widespread predictions in the press and do decide to run again, making a public announcement to this effect; in other instances, the decision has been not to run. *To attempt to make findings on whether or when the incumbent has become a candidate during this usual, oft-repeated, and varying preliminary period would render the statute unworkable. There would be a continual series of complex factual hearings, whose resolution, in view of the nature of the issue, would be most difficult and indeed might remain stubbornly speculative.* While we have used the case of an incumbent as an example, similar illustrations could be made with a nonincumbent political figure during this preliminary preannouncement period. [*Id.* at 513; emphasis added.]

[14] In essence, petitioners appear to urge a "political" issue-oriented equal opportunities doctrine. The legislative history of Section 18 of the Radio Act of 1927, (later

25. There is a further aspect of petitioners' request which is in conflict with the Congressional mandate and Commission policy under Section 315. Petitioners describe the programming subject to their request as "political advertisements." Section 315 does not speak in terms of "political" appearances. It addresses programming during which "legally qualified candidates" appear. The Commission and the courts have consistently indicated the inappropriateness of placing the broadcaster and ultimately the Commission in the role of assessing the partisan nature of an advertiser or the political or nonpolitical content of their advertisements.[15] The same policy objectives which in *Paulsen, supra,* counseled against broadcaster and Commission inquiry into the political content or intent of programming apply here as well.[16]

26. In a different context, the Commission reached a consistent conclusion with respect to the partisan nature of the purchaser, as well as the content of the programming. In *Carter/Mondale Reelection Committee,* 81 FCC 2d 409 (1980), the Commission was faced with the task of determining whether purchases by independent political committees for presentation of "uses" should trigger paid or free equal opportunities under Section 315. One approach considered and rejected as having "serious flaws" involved the "nature of the party buying the time." The Commission stated:

> Under this approach, where the purpose is partisan political, then rival candidates would be entitled only to *paid* time but that where there is some other purpose, free time would be given. To determine whether the initial purchase was motivated by a partisan political purpose the broadcaster (and ultimately the Commission) would look to statements of intent, the nature of the purchasing entity, and the content of the broadcast. Yet such an inquiry into the political or nonpolitical nature of a "use" for the purpose of determining whether opposing candidates are entitled to free rather than paid time would seem to conflict with the Commission's long-held view that such a subjective inquiry should be avoided. [Id. at 418; footnote omitted.]

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reenacted in its entirety as Section 315 of the Communications Act) indicates that Congress considered and rejected such an approach to controversial public issues in general.

[15] In *Pat Paulsen,* 33 FCC 2d 297 (B/c Bur. 1972), *review den.,* 33 FCC 2d 835 (1972), *aff'd, Paulsen v. FCC,* 491 F.2d 887 (9th Cir. 1974), the Commission ruled that an appearance was a Section 315 "use" regardless of whether the purpose or content of the appearance was political. The Ninth Circuit agreed with the Commission that a clear test for defining a "use" was far preferable and more consistent with Congressional intent than one which would require broadcasters and this Commission to distinguish between political and nonpolitical broadcasts. The court also emphasized:

> If the section were invoked only when political issues were actually discussed, detailed guidelines would have to be drawn to determine the precise contours of political discussion. [*Id.* at 889.]

[16] It should be noted that in applying *Zapple,* the broadcasters may sometimes be required to look at the content of a program to determine whether it advocates or opposes a candidate's election. But even there, they do not have to determine the precise nature of a group or its motivations in buying time.

It is evident from the above discussion that implementation of petitioners' request would also involve the broadcaster and undoubtedly the Commission in the very kind of subjective judgments avoided in the past. Although *Zapple* may require review of programming to determine if it fits the *Zapple* context, it is limited to a period of time demonstrated to be of special concern to Congress.

27. Lastly, it is argued that our present application of *Cullman* chills fundamental First Amendment rights. However, as discussed above, we believe that within the existing legal framework, petitioners seek an approach to political discussion with no less potential for inhibiting effect than that which results from the fear that *Cullman* may require free programming.[17]

Conclusion

28. We believe that Congress did not intend the result which would flow from a grant of petitioners' request, and our precedent would not support such a grant. By this result we do not ignore the reality of electioneering beyond structured campaign periods. However, *Zapple* is clearly intended to reflect the intent of Congress to confine special treatment of political discussion to distinct, identifiable periods. Furthermore, as we discussed above, the requested ruling would be subject to confusion to the extent that broadcasters may become so uncertain as to the possible contingent access rights triggered by sales of "political" broadcast time that they may choose to avoid such advertising entirely. In this context, we do not wish to become any more involved in broadcasters day-to-day programming judgments. Therefore, today's ruling is consistent with this Commission's overall goal of reducing Commission intrusiveness.

29. Accordingly, in view of the above considerations, the petition for declaratory ruling filed by CBS Inc., Gaylord Broadcasting

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[17] Although the Supreme Court in *CBS v. Democratic National Committee, supra,* considered an *initial* right of access for discussion of controversial issues of public importance, the following statement by the Court is pertinent:

> The Commission's responsibilities under a right-of-access system would tend to draw it into a continuing case-by-case determination of who should be heard and when. Indeed, the likelihood of Government involvement is so great that it has been suggested that the accepted constitutional principles against control of speech content would need to be relaxed with respect to editorial advertisements. To sacrifice First Amendment protections for a speculative gain is not warranted, and it was well within the Commission's discretion to construe the Act so as to avoid such a result. [*Id.* at 127.]

Petitioner's appear to acknowledge the potential for Commission intervention in their assertion that any problems with implementation of its request could be resolved by the Commission "on a case-by-case basis."

Company, Metromedia, Inc., and the National Association of Broadcasters IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Financial Qualifications, Issue Requested, Denied
Rules Waiver of
Short Spacing
Summary Decision

In hearing matter of mutually exclusive CP applications for UHF television station, Review Board affirmed ALJ's grant. Losing applicant failed to demonstrate circumstances warranting waiver of short-spacing requirements (Rule 73.610) and was disqualified. Board upheld ALJ's ruling refusing to modify a financial issue and granting a summary decision on limited financial issue for winning applicant.
—*Clay Television, Inc.*
BC Docket No. 81–690

FCC 83R–80

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Applications of	
CLAY TELEVISION, INC. Orange Park, Florida	BC Docket No. 81–690 File No. BPCT-801010KE
ORANGE PARK FLORIDA T.V., INC. Orange Park, Florida	BC Docket No. 81–692 File No. BPCT-801229KK
For Construction Permit	

Appearances

Thomas L. Root on behalf of Clay Television, Inc.; *John R. Feore, Jr.* and *Alan C. Campbell* on behalf of Orange Park Florida T.V., Inc.; and *Charles E. Dziedzic* and *Norman Goldstein* on behalf of the Chief, Mass Media Bureau, Federal Communications Commission.

DECISION

(Adopted: October 7, 1983; Released: October 13, 1983.)

BOARD MEMBER BLUMENTHAL FOR THE REVIEW BOARD:

1. This proceeding currently involves the mutually exclusive applications of Clay Television, Inc. (Clay) and Orange Park Florida

T.V., Inc. (OPTV) for authority to construct a new commercial UHF television broadcast station on Channel 25 in Orange Park, Florida.[1] By *Hearing Designation Order* (*HDO*), 46 Fed. Reg. 50600, published October 14, 1981, the Commission designated the applications for hearing on, *inter alia*, a short-spacing issue against OPTV and a limited financial issue against Clay. Subsequently, presiding ALJ Walter C. Miller modified the limited financial issue against Clay (FCC 82M-0439, released February 9, 1982) and specified, *inter alia*, a standard comparative issue which had inadvertently been omitted from the *HDO* and under which he permitted evidence regarding the applicants' comparative coverage of Grade B or better areas and populations. FCC 81M-3829, released December 4, 1981; FCC 81M-3832, released December 4, 1981. On March 3, 1982, the ALJ granted summary decision in favor of Clay on the financial issue (FCC 82M-0697); thereafter, in a *Supplemental Modified Initial Decision* (*SID*), released on November 5, 1982 (FCC 82D-71), the ALJ denied OPTV's application on the short-spacing issue and granted Clay's application. *SID*, Concls., paras. 11–12.[2] He added that Clay would be an easy winner under the standard comparative issue if a comparative analysis were needed. *Id.*, at para. 13.

2. This proceeding is now before the Review Board on exceptions filed by OPTV and limited exceptions filed by Clay. Initially, OPTV challenges its disqualification under the short-spacing issue and contends further that the ALJ erred in granting Clay summary decision on the limited financial issue; in failing to add a second financial issue against Clay; and in finding Clay the preferred applicant under the standard comparative issue. Both Clay and the Mass Media Bureau support the ALJ's disqualification of OPTV on the short-spacing issue. The Board has reviewed the *SID* and challenged ALJ rulings in light of the exceptions and briefs, the oral

[1] By *Memorandum Opinion and Order*, FCC 82M-0673, released March 2, 1982, the presiding Administrative Law Judge dismissed the application of Christian Communications of Clay, Inc., with prejudice, at its own request.

[2] Earlier in an *Initial Decision* (*I.D.*) released June 29, 1982 (FCC 82D-49), the ALJ dismissed Clay's application for effecting a major change violative of Section 73.3572 of the Commission's Rules, 47 CFR § 73.3572. On appeal, however, the Commission noted that the major change resulted from confusion in the Bureau's processing practices and remanded the proceeding to the ALJ for appropriate modifications of the *I.D. Clay Television, Inc.*, 50 RR 2d 406 (1982). A petition for reconsideration of the Commission's action was filed by OPTV. By *Order*, FCC 83R-40, released May 20, 1983, the Board tolled the 180 day deadline for Review Board Decisions prescribed by Section 0.362(b) pending (1) release of the full text of the Commission's *Memorandum Opinion and Order* denying OPTV's petition for reconsideration and (2) receipt of supplemental briefs by the parties pursuant to a Board directive on the question whether existing service by non-commercial television stations should be considered in evaluating the comparative showings in this proceeding. On July 27, 1983, the full text of the Commission's opinion was released. FCC 83–230. Additionally, the latter question regarding the comparative issue is now moot in light of our disposition. *See infra.*, para. 2.

arguments of the parties held February 18, 1983, and our examination of the record. We adopt the findings of fact in the *SID*, except as modified herein and, for the reasons stated below, affirm the ALJ's ultimate conclusion that OPTV's application must be denied on the short-spacing issue. Moreover, we affirm the challenged summary decision, the ALJ's ruling declining to add a financial issue against Clay, and grant of Clay's application. In view of our disposition, we need not and have not passed upon the exceptions to the ALJ's findings and conclusions under the comparative issue. *See Guinan* v. *F.C.C.*, 111 U.S. App. D.C. 371, 297 F.2d 782 (1961); *James B. Francis*, 41 FCC 2d 303, 304 n.3 (Rev. Bd. 1973). *See also* Section 1.282(b)(2) of the Commission's Rules, 47 CFR § 1.282(b)(2). We now turn to the short-spacing issue.

Short-spacing Issue

3. A short-spacing issue was specified in this proceeding because OPTV's proposed transmitter site for Channel 25 failed to meet the minimum mileage separation requirements of Section 73.610 of the Commission's Rules with respect to a site proposed by Life Style Broadcasting, Inc. in an earlier filed, and currently pending, application for a new UHF television station to operate on Channel 26, Daytona Beach, Florida.[3] Section 73.610 requires a separation of at least 55 miles between adjacent channel UHF television stations or pending applications (*see* Section 73.611)(b)(4)) and OPTV's proposed site is located only 52.36 miles from Life Style's proposed site. *SID*, Concls. para. 4. The issue, as framed, seeks to determine whether the potential interference would be insignificant and, if so, whether circumstances exist that would warrant a waiver of Section 73.610.

4. In *SID*, the ALJ found that OPTV's application must be denied because OPTV failed to sustain its burden of proceeding in establishing whether the potential interference would be significant or not. *SID*, Concls., para. 7. He pointed out that OPTV never even calculated the size of its affected area or population, but relied instead on a showing that "equivalent protection" would be provided to Life Style. That is, OPTV would purportedly reduce its radiated power until the interference caused to Life Style would be no greater than the interference generally experienced by a properly space station operating at the maximum permissible power. *See Id.*, paras. 16–17; Concls. 7–8. The ALJ noted, however, that the "equivalent protection" doctrine has not been extended to the UHF service and

[3] OPTV would meet the minimum spacing requirements as to the other applicants in the Daytona Beach comparative hearing. In an *Initial Decision*, released April 25, 1983 (FCC 83D-27), Life Style's application was denied after a competing applicant was found to be comparatively superior. Exceptions have been filed before the Review Board, and a final determination in that proceeding has not yet been reached.

he further found that, even if OPTV had sustained its burden above, it still would not be entitled to a waiver of Section 73.610 since it failed to make a threshold showing that suitable non-short-spaced sites are not available. Thus, a second independent reason exists for denying OPTV's application. *SID*, Concls. paras. 9–11. OPTV excepts to the ALJ's conclusions concerning both aspects of the issue, arguing (1) that the ALJ imposed an arbitrary standard of proof in reviewing OPTV's showing of interference; and, (2) that the ALJ ignored Commission precedent in evaluating its waiver request.

5. We conclude that the ALJ correctly found that OPTV was not entitled to a waiver of Section 73.610 and that its application therefore must be denied. As a preliminary matter, we concur with the ALJ that OPTV failed to sustain its burden of proceeding with respect to the significance of the potential interference caused by its short-spaced proposal since the concept of "equivalent protection," primarily relied upon by OPTV for satisfying this burden,[4] is limited to the VHF service. *New Jersey Public Broadcasting Authority*, 50 RR 2d 251 (1981); *see also Pappas Telecasting, Inc.*, 49 RR 2d 1688, 1690 (1981). Absent a proffer of a satisfactorily valid alternative approach in quantifying interference, we shall not fault the ALJ, as urged by OPTV, for determining that OPTV's burden of proceeding required it -at a minimum - to provide evidence as to the areas and populations that would suffer interference from its proposal.[5] OPTV's contention that the ALJ imposed an arbitrary standard of proof is rejected since any burden would start at some reasonable quantitative estimate of interference to the public.

6. Equally important, the Board agrees with the ALJ that OPTV failed to demonstrate adequate circumstances that would warrant a waiver of Section 73.610 of our rules. The Commission has previously stated that "our rules presumptively serve the public interest" and that "those seeking waiver have the burden of establishing that the public interest is better served by a waiver than by application of the appropriate rules." *See, e.g., New Jersey Public Broadcasting Author-*

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[4] OPTV also notes that its engineer testified that, in his opinion, the interference could only be labelled as insignificant. We agree with the ALJ (*see SID*, n.19) that this opinion could not sustain OPTV's burden since the areas and populations affected had not been ascertained with *any* degree of specificity. See Tr. 312–14.

[5] OPTV also argues that the ALJ erred in refusing to permit it to submit a supplemental engineering exhibit following the Commission's remand of this proceeding to the ALJ. *See supra*, n.2. We disagree. The proceeding was remanded to the ALJ for the limited purpose of dealing with Clay's major amendment. *Id.* OPTV had ample opportunity to meet its burden under the issue at the time of hearing. As the court of appeals held: "We cannot allow the appellant to sit back and hope that a decision will be in its favor, and then, when it isn't, to parry with an offer of more evidence. No judging process in any branch of government could operate efficiently or accurately if such a procedure were allowed." *Colorado Radio Corp.* v. *F.C.C.*, 73 App. D.C. 225, 227, 118, F.2d 24, 26 (1941). That principle is surely applicable here.

ity, 74 FCC 2d 602, 604 (1979). Here, in support of its waiver request, OPTV recites the following factors which it claims the ALJ failed to consider: absence of a suitable alternative site, alleged coverage superiority,[6] and the equities of this case, *i.e.*, Life Style's failure to protect the Commission assigned reference point for Channel 25 at Orange Park as required by Section 73.611 of our Rules.

7. We perceive no error on the part of the ALJ, nor -more importantly- are we persuaded that the foregoing reasons show that the public interest would be better served by waiver of our rules. First, the ALJ correctly observed that non-short-spaced sites are available. *SID*, Concls., para. 10. OPTV concedes this, but argues that the appropriate inquiry is whether there are alternative sites that meet its service specification, *viz.*, a fully spaced site where the 1000 foot tower it proposes can be located without objection by the Federal Aviation Administration, *citing WSET, Inc.*, 80 FCC 2d 233 (1980). We disagree. In *WSET*, the Commission permitted a Lynchburg VHF licensee, short-spaced 8.38 miles to a co-channel station, to move its antenna site to a new location short-spaced 7 miles (to a different co-channel station) in order to eliminate shadowing in Lynchburg and Roanoke, Virginia, both of which lay within that licensee's city grade contour. The Commission rejected arguments that the licensee should be required to locate in a properly spaced site that would permit it solely to enhance its signal to Lynchburg, stating that the real issue was whether a site was available that would improve service to both communities. 80 FCC 2d at 242. That case does not stand for the proposition that an applicant for an initial license may circumvent the usual threshold requirement set forth in *Townsend Broadcasting Corp.*, 62 FCC 2d 511 (1976) of demonstrating the nonavailability of suitable non-short-spaced sites by merely showing, as here, the nonavailability of a site that would meet its own self-imposed standard.[7] Second, the ALJ correctly refused to consider OPTV's "superior coverage" in evaluating its waiver request. As aptly pointed out by the Bureau, OPTV submitted no evidence whatever with respect to the magnitude of service that would be lost as a result of the interference; and, thus, it was not possible to make a determination on this factor as to whether a waiver was justified. Moreover, OPTV never attempted to establish that it could not provide much of the increased coverage from a properly spaced site using a permissible higher tower than that proposed by its competitor, that is, above 500 feet. And, a waiver of

[6] OPTV claims that its Grade B contour will serve 130, 922 persons more than Clay's proposal and will provide a second service to 3150 persons, a third service to 55,980 persons, and a fourth service to 16,661 persons.

[7] We do not reach Clay's contention that OPTV failed to show that a 1000 foot tower could not be located in a properly spaced site.

the short-spacing requirements is not justified merely to allow one to obtain a comparative advantage over its competitor.[8] Were we to allow this result, it would signal that the Commission's fundamental concern with the integrity of the spectrum is secondary to an applicant's desire to improve its comparative position at the expense of other licensees and the public. Almost any applicant could serve more people if it ignored our technical spacing requirements; that is no feat. But, it cannot be allowed for obvious reasons. Finally, the ALJ properly ignored Life Style's application in his waiver evaluation. Although Life Style's application, as filed, failed to protect the reference point for Orange Park as required by Section 73.611 of our rules, the application was amended as of October 1, 1981 to provide such protection. *See* OPTV Exh. 7, p. 3. OPTV's contention that the ALJ ignored Commission precedent in evaluating the waiver request is without merit and its application was properly denied. *Cf. Garo W. Ray*, 36 FCC 1038, 1041 (Rev. Bd. 1964).

Financial Issue

8. *Enlargement of Financial Issue.* The *HDO* specified a limited financial issue against Clay to determine whether it could obtain an additional $300,237 to construct and operate its proposal. *See id., supra*, at 50601. By a petition to enlarge issues filed January 6, 1982, OPTV sought amendment of the issue to determine whether $487,626 in equipment credit financing by the Midwest Corporation[9], relied upon by Clay, was available. The request was based on two letters appended to the petition: one, by OPTV's counsel to Midwest reciting that its understanding was that Midwest's policy on deferred payment purchases was to rely on third party financing; and, two, an unattested letter, by Midwest's corporate credit manager, Harold Elswick, stating that OPTV's letter "is basically correct." OPTV argued, in essence, that inasmuch as a third party was not identified (and perhaps did not exist), an issue was required to determine whether the financing was available. The ALJ denied the requested issue. *See* FCC 82M-0439, *supra*.[10] OPTV contends that the ALJ erred in refusing to add the issue. We disagree. Motions seeking enlargement or modification of the issues must contain specific allegations of fact and be supported by affidavits of a person or persons having personal knowledge thereof. *See* Section 1.229(d) of the Commission's Rules, 47 CFR § 1.229(d). Here, the letters forming

[8] OPTV had the option of moving into an area that complied with Section 73.610 or in seeking a waiver. It chose the latter approach. *See SID*, paras. 13–14; Concls. para. 5.

[9] Midwest Telecommunications Systems Division of Unarco Midwest Corporation (Midwest).

[10] On another ground not relevant here, the ALJ clarified the issue to determine whether Clay could show the availability of $420,237 rather than the $300,237 referred to in the *HDO*.

the basis of OPTV's request do not discuss the particulars of the specific commitment letter from Midwest to Clay, nor are they supported by affidavit. On the other hand, Clay submitted the affidavit of Harold Elswick which averred "that Midwest will use any means of financing necessary and appropriate to provide financing . . . including in-house financing." *See* Clay's opposition to OPTV's petition. Elswick added that Midwest continues to consider its letter to Clay as a valid statement of its intention to provide the financing to Clay. *Id.* Absent a stronger showing by OPTV, the enlargement request was properly denied.

9. *Summary Decision on Financial Issue.* By *Memorandum Opinion and Order*, FCC 82M-0697, *supra*, the ALJ granted Clay's motion for summary decision on the limited financial issue, finding that Clay had $500,001 available to meet its obligations of $420,237. *See supra*, note 10. In so doing, he noted that the Bank of Green Cove Springs firmly commited itself to lend three of Clay's stockholders $180,000 each and that these stockholders would in turn lend the net proceeds of their loans ($166,667) to the applicant. OPTV excepts to the ALJ's grant of the summary decision. Initially, it argues that a hearing was required in order to identify the third party financier which would undertake to finance Clay's purchase of equipment. This argument has been rejected, *see supra*, para. 8, and warrants no further discussion.

10. Secondly, OPTV denounces Clay's method of financing (*i.e.*, loans from the three stockholders) as a "game of mirrors" which the Commission should not condone. OPTV asserts that the individual loans will be financed by a bank on which one of the Clay stockholders sits as a director, and that Clay has sought to immunize its financial plan from further scrutiny by transferring the financial uncertainty from the applicant to its stockholders. This argument is also rejected. OPTV has cited no Commission precedent requiring an applicant to demonstrate that its principals can repay loans secured for the purpose of financing the construction of a broadcast station, and we discern no justification for adding such a showing. The shareholders in question are practicing physicians; all have substantial net worths; and two of the three have long-standing relationships with the bank. *See* Motion for Partial Summary Decision, Attachments 10; 8, pp. 9–10. Clay was simply required to demonstrate that it's financing was reasonably available and has done so. All three shareholders have agreed to lend the proceeds of their loans to the applicant. *Id.*, at Attachment 4. Further, The Green Cove Springs bank commitment letters to the Clay stockholders and the deposition testimony of the bank signatory, who is Chairman of the Board and President of the bank, clearly reflect that the bank was familiar with the financial conditions of the borrowers, that it was aware that the loans would be used to help the borrowers meet their commitments to the applicant, and that the commitments are

firm. *Id.*, Attachment 8, at 11, 13, 16, 22, 41; Attachment 9. Finally, the loans have been approved by the Board of Directors of the bank. *See* Clay amendment, filed February 17, 1982. There not being any genuine issue of fact concerning Clay's financial qualifications, summary decision was properly granted. *See* Section 1.251 of the Commission's Rules, 47 CFR § 1.251.

11. ACCORDINGLY, IT IS ORDERED, That the petitions for leave to amend, filed December 1, 1982, and January 1, February 14, April 18 and 26, and July 29, 1983, by Orange Park Florida T.V., Inc. ARE GRANTED and the amendments ARE ACCEPTED; and

12. IT IS FURTHER ORDERED, That the application of Clay Television, Inc. (File No. BPCT-801010KE) for a construction permit to establish a new television station at Orange Park, Florida IS GRANTED, and that the application of Orange Park Florida T.V., Inc. (File No. BPCT-801229KK) IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION
NORMAN B. BLUMENTHAL, *Member, Review Board*

FCC 82D–71

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Applications of	
CLAY TELEVISION, INC. Orange Park, Florida	BC Docket No. 81–690 File No. BPCT-801010KE
ORANGE PARK FLORIDA T.V., INC. Orange Park, Florida	BC Docket No. 81–692 File No. BPCT-801229KK
For Construction Permit	

Appearances

Thomas L. Root on behalf of Clay Television, Inc.; *John R. Feore Jr.*, *Michael A. Pace*, and *Alan C. Campbell* on behalf of Orange Park Florida T.V., Inc.; and *Norman Goldstein* on behalf of Chief, Broadcast Bureau, Federal Communications Commission.

SUPPLEMENTAL MODIFIED INITIAL DECISION OF ADMINISTRATIVE LAW JUDGE WALTER C. MILLER

(Issued: October 28, 1982; Released: November 5, 1982)

Preliminary Statement

1. This is a mutually-exclusive contest for a construction permit to operate a new commercial television station on Channel 25, Orange Park, Florida. Two applicants remain:[1] Clay Television, Inc. (Clay) and Orange Park Florida T.V., Inc. (OPTV).

2. After the hearings were completed an Initial Decision was released. See FCC 82D-49 released June 29, 1982. However, on September 21, 1982, the Commission ruled on an interlocutory question that had been presented to them. Consequently they remanded the case to the Presiding Officer and ordered him to appropriately modify his Initial Decision consistent with their holdings. See FCC 82–417 released September 21, 1982.

3. The Presiding Officer then reopened the record and scheduled a further hearing conference (FCC 82M-2946, released September 23, 1982). And on October 15, 1982, the Presiding Officer granted an

[1] A third application - that of Christian Communications of Clay, Inc. (BPCT-801229KH) - was dismissed March 2, 1982. See FCC 82M-0673.

amendment filed by Clay and indicated that he was ready to comply with the Commission's instructions (FCC 82M-3205 released October 15, 1982). This Supplemental Initial Decision has been modified to reflect the Commission's reasoning.[2]

4. The following issues remain for resolution:

(1) To determine with respect to Orange Park T.V., Inc., whether, operating as proposed, the potential interference would be insignificant, and, if so, whether circumstances exist which would warrant a waiver of Section 73.610 of the Commission's Rules.

(2) To determine on a comparative basis, which of the applicants would better serve the public interest, convenience, and necessity. In connection with Issue 2, to determine the areas and populations which would receive primary television service (Grade B or better) from each of the applicants and the other primary television service available to such areas and populations.

(3) To determine, in light of the evidence adduced pursuant to the foregoing issues, which (if either) of the applications should be granted.

5. The burden of proceeding and the burden of proof under Issue 1 is on OPTV; and on Issues 2–3 on each of the applicants.

Issue 1 - OPTV's Short-Spacing Issue

6. On August 11, 1980, several months before OPTV even decided to file an application for Orange Park, another applicant in another proceeding, Life Style, Inc. (Life Style), applied for an adjacent TV channel in Daytona Beach, Florida.

7. OPTV decided to file its Orange Park application (BPCT-801229KK) in November, 1980.[3] At that time it sent its then consulting engineer to the community to locate a tower and transmitter site. It instructed that engineer to select a site which would provide a city-grade contour over Orange Park, provide maximum area and population coverage and still comply with all FCC and FAA regulations.

8. At that time OPTV's engineer wasn't aware that Life Style had filed an adjacent channel application for Daytona Beach. Consequently, he determined that OPTV could maximize its coverage if it proposed a tower with a height above average terrain of more than 950 feet. However, he also recognized that this 950 foot-plus-constraint would limit the possible tower locations to a very

[2] On October 22, 1982, OPTV filed a Petition for Reconsideration with the Commission. There it seeks modification of FCC 82–417 *supra*. So under 47 CFR 1.291(d), this Supplemental Decision can't become effective until after that request is ruled on.

[3] Clay Television, Inc. had already filed its application (BPCT-801010KE) the previous month; i.e., on October 10, 1980. So OPTV was aware that if it filed for Orange Park it faced a potential competitive hearing.

small area because of FAA restrictions and the amount of land required for guying so tall a tower.[4]

9. The consulting engineer located and recommended what he thought was a potential site that met all the requirements. That is the only site he considered. That is the site on which OPTV has obtained an option and proposes to locate its tower and transmiter (described in para. 10 *infra*).

10. On December 29, 1980 (the cut-off date), OPTV filed its application. It proposed to locate its tower at a site near Penney Farms, Florida. The tower would be 954 feet above the ground and 1,049 feet above mean sea level. However, the site OPTV has selected is only 52.36 miles from the earlier-filed Life Style proposed site. So OPTV's proposed site is short-spaced by 2.64 miles[5] and can't be granted without a waiver of 47 CFR 73.610.[6]

11. This led the Commission to designate the short-spacing issue involved here (see para. 4 and 46 FR 50600, published October 14, 1981). And in the designation order it called on OPTV to make two showings. First the Commission expressly called on OPTV to show whether the potential interference was significant or not. And if the amount of interference proved significant then the Commission called on OPTV to show that circumstances exist which would warrant waiving the 47 CFR 73.610 violation. See 47 FR 50600 *supra*.

12. Until the designation order was issued on October 2, 1981, OPTV remained unaware that its application was short-spaced with Life Style's.[7] Shortly after designation it retained a new consulting engineer, John J. Mullaney (Tr. 227–229, 233, 240).

13. Mullaney looked over the short-spaced situation. He decided that there were two alternatives: (1) OPTV could move into an area that would comply with 47 CFR 73.610; or (2) stay at the present location and take a chance on whether or not waiver will be granted (Tr. 250–251).

14. Mullaney recommended the second alternative. He felt a change of location would be unwise because of the possibility that the FAA wouldn't issue a no hazard determination until OPTV reduced its tower height significantly. This tower height reduction, in turn, would reduce the area and population served. OPTV adopted Mullaney's recommendation. It decided to "Stick it out." Conse-

[4] The site was selected contemplating 70% guying (the industry guying standard) and thus required 20 acres. Only about 15.6 acres would be needed for 50% guying, but this would increase the cost of the tower.

[5] At one time OPTV's proposed site was short-spaced with Life Style's by 5.5 miles. However, Life Style has subsequently reduced the amount of short-spacing by amending its application (Tr. 270).

[6] 47 CFR 73.610 requires a minimum separation of 55 miles between adjacent channel UHF television stations.

[7] OPTV even went ahead, on December 23, 1980 and applied for a no hazard determination with the FAA. A determination of no hazard for the site was issued on September 16, 1981 (Clay Ex. 11, p. 1).

quently, it didn't consider a site change (Tr. 233–234, 250–252, 290–291, 332–337, and 423–424).[8]

15. It wasn't until he prepared his testimony that Mullaney determined the triangular area where a tower could be located without requiring a waiver of the rules. Both Clay, who had filed earlier (see Footnote 3 *supra.*) and Christian (see Footnote 1 *supra.*) had specified sites within that triangular area (OPTV Ex. 7, p. 5).

16. At the hearing OPTV made no attempt to meet the first part of designated short-spacing issue. Mullaney made no attempt to determine whether the interference was significant or not (see Finding 11 *supra.*). He didn't calculate the size of its affected area or its population. In fact he never even considered such a calculation (Tr. 270–272).

17. Instead Mullaney relied on a showing that equivalent protection would be provided to Life Style (Tr. 262, 267–268, 304–307). That analysis showed that if OPTV could find a properly spaced site, using an antenna whose HAAT was 2,000 feet,[9] it would create significantly more interference than would its presently proposed operation (Tr. 274).

18. Although he made no effort to calculate the interference caused by the short-spacing (Finding 16 *supra.*), Mullaney offered certain opinions about such interference as it relates to his equivalent protection contention. He speculates that the interference would only be about 1 to 11;2 miles deep at its maximum;[10] and that it would occur in a rural area; i.e., one that doesn't contain any large cities (Tr. 290, 312, 341). Based on those non-documented contentions, Mullaney then concludes that the area of potential interference is insignificant when compared with his interpretation of what the rules would allow (Tr. 310–314).

19. OPTV also hired an aeronautical consultant, N. Stanley Kingham, to testify in this case. He testified on whether a 1,000 foot tower on a site in the approved triangular area (see Finding 14 *supra.*) would be approved by the FAA.[11] It was his opinion that the FAA would find a 1,000 foot tower in the triangular area a hazard to air navigation; he further opined that a request for approval of a tower between 300 and 1,000 feet in height would require a closer look and would possibly be approved. In fact he gave the opinion that a 749 foot tower in the triangular area would have a fifty-fifty

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[8] Because OPTV has decided to proceed with its original site, Mullaney has never reviewed OPTV's site requirements or land availability.

[9] With its proposed 5 kW power this would then represent a maximum permissible facility (§ 73.614(b)).

[10] Of course, since OPTV made no engineering calculations there is no evidence on over what arc this interference would occur.

[11] The FAA doesn't issue declaratory rulings. A specific proposal must be submitted to it (Tr. 334).

chance of receiving air hazard clearance (OPTV Exs. 7–8; Tr. 445–462).[12] [13]

Issue 2 - The Standard Comparative Issue

20. *Description of Applicants - Clay.* Clay Television, a Florida corporation, was formed in 1978. It is authorized 7500 shares but only 800 have been issued. The following chart sets out the details on Clay's officers, directors, and/or stockholders:

Clay

Person	*Ownership Percentage*	*Office*	*Director*
Charles R. Fellows	12.5%	President	Yes
Richard C. Fellows	12.5%	_____	Yes
Joan J. Bazley	26.0%	Secretary	Yes
Joanne Thompson	12.0%	Vice-President	Yes
Leonora Leano	11.0%	Treasurer	Yes
William Bazley	1.0%	_____	—
W. Raleigh Thompson	12.0%	_____	—
Napoleon Leano	13.0%	_____	—

21. *Orange Park Florida T.V., Inc.*, Orange Park, a Delaware Corporation is authorized 1250 shares of common stock. 1000 of those shares have been issued, and 250 shares have been subscribed. The following chart sets out the details on OPTV's officers, directors, and/or stockholders:

OPTV

Person	*Ownership Percentage*	*Office*	*Director*
Malcolm I. Glazer	80%	President	Yes
Robert J. McCullough	20%	Vice-President	No
Carl Brasley	—	Secretary-President	No
James A. Underwood	—	Vice-President	No
David Murphy	—	Vice-President	No

22. *Diversification of Mass Media - Clay.* Neither Clay nor any of its eight principals have any ownership interest in any other broadcast station, cable television system, newspaper or other mass communications medium.

23. *OPTV.* OPTV has no ownership in any broadcast station or other mass communications medium. However, several of OPTV's

[12] Clay's counsel cross-examined Kingham at some length on the basis of his opinion without seriously undermining his opinions (Tr. 357–443; 466–468).

[13] OPTV also contends that its superior coverage position vis-a-vis Clay should be considered in determining whether to grant it a waiver of its 47 CFR 73.610 violation. This contention is rejected. Any areas and population advantage that OPTV may have will be considered under the standard comparative issue. That is Commission policy. OPTV cannot be permitted to "double-count" any comparative advantage it may have.

principals have such interests. *Malcolm I. Glazer* is the President, Director and sole stockholder of the licensee corporations of WTWO-TV, Terre Haute, Indiana; KQTV (TV), St. Joseph, Missouri; and WRBL (TV), Columbus, Georgia.[14] He is also President, Director and possesses interest in the following:

Additional Glazer Interests

Entity and Interest	*Percentage of Ownership*
Irving Texas T.V. Inc., applicant for a new commercial UHF TV Station, Irving, Texas	80%
Toledo, Ohio, T.V. Inc., applicant for a new commercial UHF TV Station, Toledo, Ohio	80%[15]

Additional Glazer Interests

Entity and Interest	*Percentage of Ownership*
Knoxville, Tennessee, T.V. Inc., applicant for a new commercial UHF TV Station, Knoxville, Tennessee	51%
Hammond, Indiana T.V. Inc., applicant for a new commercial UHF TV Station, Hammond, Indiana	51%
Salt Lake City T.V. Inc., applicant for a new commercial UHF TV Station, Salt Lake City, Utah	51%
TV American Corporation, application for LPTV Stations in (1) Terre Haute, Indiana; (2), Portland, Oregon; (3) Columbus, Georgia; and (4) Baltimore, Maryland	100%

24. *Carl Brasley* is Secretary-Treasurer of KQTV (TV), St. Joseph, Missouri; Assistant Secretary and Director of WTWO-TV, Terre Haute, Indiana; Secretary-Treasurer and Director of WRBL (TV); and Secretary-Treasurer of the applicants listed on the paragraph 23 chart.

25. *James Underwood* is Executive Vice President, Director, and General Manager of WRBL (TV), Columbus, Georgia. *David Murphy* is Operations Manager at the same station.

26. *Integration of Ownership With Management - Clay.* Clay seeks 49% integration credit. It intends to integrate three of its eight stockholders.

27. Clay will fully integrate its Secretary, Director, and 26% stockholder, *Joan Bazley*, into its day-to-day operation. Mrs. Bazley will be the full-time Public Affairs Director of the proposed station. In that capacity she will be responsible for producing the public

[14] WRBL (TV) is located about 265 air miles from Orange Park; WTWO-TV is about 715 miles away; and KQTV (TV) is 975 miles away.

[15] Toledo Ohio T.V. Inc. has entered into a settlement agreement to dismiss its UHF application in return for reimbursement of the expenses it incurred prosecuting its application. See FCC 82M-1880 released June 16, 1982.

affairs schedule. She will select the participants and topics to be treated by public affairs programming; she'll maintain contact with Orange Park and Clay County citizens to ascertain public affairs problems; and she'll participate with the other principals in setting the program policies of the station.

28. Joan Bazley was born in Schenectady, New York in 1944. She graduated from the Jackson Memorial Hospital School of Nursing, Miami, Florida. She and her family have resided in Green Cove Springs since 1972. Green Cove Springs is in Clay County - about 12 miles south of Orange Park.

29. Since 1975 Mrs. Bazley has been employed part-time for her husband William S. Bazley, M.D. Her duties include bookkeeping and investment control for pension plans and similar accounts for the professional corporation. If Clay is granted a CP, she'll resign this position. From June 1977 to April 1981 she was also the owner of a retail store that specialized in the sale of hand-crafted items. She liquidated her inventory and closed the store in April, 1981.

30. Mrs. Bazley has no broadcast experience. She has never worked in a television station and has never been involved in television programming production. Most of her civic activities aren't directly concerned with Orange Park - the proposed city of license. However, for the past five years she has been a member of the Friends of the Orange Park Library (Clay Ex. 2; Tr. 113–140).

31. Next Clay will fully integrate its Vice-President, Director, and 12% stockholder, *Joanne Thompson*, into the station's day-to-day operation. She will be Clay's full-time (at least 40 hours per week) continuity/community affairs director. In that capacity she'll review programming material to see that it meets station standards. She'll also be responsible for producing the station's educational programming; she'll maintain contact with the area schools, collect information for public service announcements and solicit educational problems, topics and activities.

32. Joanne Thompson was born and raised in Jacksonville, Florida. She and her husband have resided in Orange Park since 1967. She hasn't been employed for the past 25 years.

33. Mrs. Thompson has no broadcast experience. But she has studied broadcasting books to familiarize herself with television broadcasting.

34. She has been a member of the Grace Episcopal Church in Orange Park since 1967. She has been active in church activities; e.g. she taught Sunday School for five years. She has been a member of the Friends of the Orange Park Library for five years and a member of the Clay County Medical Society Auxiliary since 1975. She is also a member of the Orange Park Garden Club and has been since 1967; and she is a Saber Club member - an auxiliary of the Shrine - and as such helps out in fund-raising for aiding crippled children (Clay Ex. 6; Tr. 145–158).

35. Finally, Clay will fully integrate its Treasurer, Director, and 11% stockholder, *Leonora Leano*, into the station's day-to-day operation. Mrs. Leano will be Clay's full-time (minimum of 40 hours weekly) director of minority and children's programming. In that capacity she will be responsible for coordinating and producing children's programs and programs of concern to minority groups (Tr. 170–177; Clay Ex. 7, p. 4).

36. Mrs. Leano is an Asian American. She was born in the Phillipines and obtained her medical degree there. She has completed her medical residency in 1971. She practiced medicine from 1978 to 1979, specializing in pediatrics. She left medical practice in 1979 and doesn't propose to resume it - even on a part-time basis. She'd rather work in television because the regular hours of her position at the television station would permit her time with her family.[16] She may work hours of 8:00 a.m. to 3:00 p.m. during the week, with extra hours in the evening or on the weekend to fulfill her 40 hour commitment (Tr. 177).

37. She and her family have lived in Orange Park since 1976.

38. Leonora Leano has no broadcast experience and has never even been inside a television station (Tr. 177). She is a member of the Greater Orange Park Community Hospital medical staff; the Clay County Medical Society Auxiliary; the St. Catherine Catholic Church; and the Parents-Teachers League of St. John's Country Day School (Clay Ex. 7).

39. *OPTV*. OPTV seeks 20% integration credit. It intends to integrate one of its stockholders.

40. OPTV will fully integrate its Vice-President, and 20% stockholder, *Robert McCullough*, into its proposed day-to-day operations. McCullough will be the station's full-time General Manager and will devote a minimum of 40 hours a week to the station's operations. In his capacity of General Manager, McCullough will direct all aspects of the station's operations including programming, sales, promotion and engineering. All department heads and managerial employees will report to him. He will establish the station's policies and practices and be primarily responsible for EEO and personnel decisions.

41. Robert McCullough was born and raised in Stamford, Connecticut. He currently resides in Stamford but will move his family to Clay County if OPTV's application is granted (Tr. 211). From 1947 through 1951 McCullough attended the University of Bridgeport; he majored in sales and advertising. He served in the Navy for two years and was honorably discharged.

42. McCullough worked for the Stamford *Advocate* newspaper

[16] Mrs. Leano isn't concerned about how much money she was making as a pediatrician or how much she'll make as Clay's director of minority and children's programming. Her husband is a physician specializing in anesthesiology, and makes a sufficient income (Tr. 173–176, 191).

from 1953 to 1959. From 1959 to 1970 he was employed by the Greenwich *Time* newspaper. He started with the *Time* as the Classified Advertising Manager; then he became Business Manager; and finally he became General Manager.

43. From November 27, 1970 until March 11, 1982, when the stations were sold, he was General Manager of Stations WSTC and WYRS (FM), Stamford, Connecticut (OPTV Ex. 4). McCullough has never been to Orange Park or Clay County, Florida (Tr. 211–212).

44. *Auxiliary Power.* OPTV proposes to install and maintain an auxiliary power generator to assure the station's continuous operation if the power fails. This auxiliary generator will have automatic starting features. Clay doesn't propose to use auxiliary power generating equipment.

45. *Comparative Coverage.* Both applicants seek a UHF CP for Channel 25, Orange Park, Florida. Orange Park, located in Clay County, is about 11 miles south of Jacksonville, Florida. No television stations are licensed to Orange Park.

46. Clay proposes an antenna whose height above average terrain is 496 feet and an ERP of 2,060 kW. OPTV proposes an antenna whose HAAT is 954 feet and an ERP of 5,000 kW.

47. Because they propose different powers, antenna heights and site locations, their proposed Grade B primary service contours would embrace different areas and populations. OPTV's proposed primary service contour completely encompasses Clay's.[17] The following chart shows the primary service picture:

Primary Service

Applicant	*Area (sq. mi.)*	*Population*
Clay	3,307	620,896
OPTV	6,904	751,818
OPTV's advantage	2,787	130,922
	(84.3%)	(21.1%)

48. In addition, and since OPTV's contour embraces Clay's, there are underserved areas and populations that OPTV will serve that Clay doesn't. In fact OPTV would serve a TV grey area that Clay wouldn't. The following chart shows OPTV's exclusive service:

OPTV's Exclusively Served Areas

Area (sq. mi.)	*Population*	*Number of Existing Services*
68	3,150	1
276	55,980	2
209	16,661	3

[17] It must be remembered that OPTV has secured at least part of its areas and populations advantage at the price of a short-spacing violation. See Findings 6–19 *supra.*

Ultimate Findings and Preliminary Conclusions

1. Orange Park Florida T.V., Inc. (OPTV) and Clay Television, Inc. (Clay) each seek authority to operate a new UHF television station on Channel 25, Orange Park, Florida.

2. Two issues need to be resolved. OPTV faces a 47 CFR 73.610 (short-spacing) violation issue; i.e., designated Issue 1. The second issue is the standard comparative issue.

3. OPTV's basic qualifying issue must be resolved first. For it is axiomatic that only basically qualified applicants are entitled to comparative consideration. See e.g. *Louis Adelman*, 29 FCC 1223, 18 RR 1062 (1960), *affirmed sub. nom. Guinan v. Federal Communications Commission*, 297 F.2d 782, 22 RR 2026 (1961).

OPTV's Short-Spacing Issue

4. 47 CFR 73.610 requires a minimum separation of 55 miles between adjacent channel UHF television stations. OPTV proposes a site that is 52.36 miles from Life Style Broadcasting, Inc.'s adjacent channel Daytona Beach, Florida site. So OPTV violates §73.610; it's short-spaced by over 2 1/2 miles.[18]

5. OPTV has been aware of its short-spacing problems since shortly after the designation order was issued on October 2, 1981. At that time it changed consulting engineers and hired John J. Mullaney to study the problem. Mullaney told OPTV not to amend to a site that would comply with 47 CFR 73.610. Instead he advised OPTV to gamble that it could obtain a waiver of the violation. Mullaney didn't want to have to reduce the height of the 954 foot tower because that would result in a loss of OPTV's areas and populations. So he told OPTV to "stick it out." OPTV followed that advice.

6. Under the terms of the designated issue, and if it was to meet its burdens of proceeding and proof, OPTV was obligated to make two showings. First it had to show whether the interference resulting from the short-spacing was significant or not. Then, if the interference proved significant, OPTV was to demonstrate that circumstances exist that would warrant waiving a 73.610 violation of that magnitude.

7. OPTV has failed to meet the short-spacing issue, and its application must be denied. First of all it failed to show whether the short-spaced interference was significant or not. It produced no evidence on the areas and populations which would be subject to interference because of its deliberate short-spacing. Mullaney not only never calculated the interference he never even considered

[18] As previously noted (Finding 16 *supra.*) since OPTV has made no attempt to calculate the interference the record doesn't reflect the length of the interference area or over what area it would extend.

making such a calculation. So OPTV has failed to sustain its burden of proceeding on Issue 1 and its application must be denied.[19]

8. Mullaney asserts that he didn't need to determine whether the short-spaced interference is significant or not since he would address the problem on the basis of "equivalent protection." That assertion is rejected. The Broadcast Bureau is right. The "equivalent protection" rationale hasn't been extended to UHF service. See *Carolina Christian Broadcasting, Inc.*, 48 RR 2d 355 (1980) at 358.[20]

9. Secondly, and even *assuming* that OPTV had shown the nature and extent of the short-spaced interference it would still not be entitled to a waiver of its § 73.610 violation. It has failed to make the threshold showing that suitable non-short-spaced sites aren't available. See *Townsend Broadcasting Corporation*, 62 FCC 2d 511 (1976) at 512.

10. Indeed it is impossible for OPTV to show that non-short-spaced sites are unavailable. The record shows that Clay's proposed site and the site formerly proposed by Christian Communications of Clay, Inc. (see Footnote 1 *supra.*) both meet 47 CFR 73.610's spacing requirements. The record further shows that there is another additional area where an antenna could be located that would comply with § 73.610.

11. The situation is clear. OPTV was interested in its antenna height and extended coverage more than it was in correcting its 47 CFR 73.610 violation. It was well aware the violation existed. It knew sites were available that would cure the violation. But it didn't bother looking for such a site. This forms a second and independent reason for denying OPTV's application. It is therefore concluded that OPTV isn't technically qualified to be a Commission licensee.

Final Conclusion

12. The standard comparative issue (Issue 2) needn't be analyzed.[21] Clay is basically qualified to be a Commission licensee. OPTV isn't. So Clay can be granted.

13. However, *assuming arguendo* a comparative analysis were needed Clay would still prevail. It would be entitled to a substantial preference under the Diversification of Mass Media criterion. Compare Finding 22 with Findings 23–25 *supra*. And its 49%

[19] Mullaney belatedly, at the hearing, tried to argue that the short-spaced interference was minor. This belated argument won't be credited. It cannot be considered a surrogate for the detail that the Commission is entitled to when areas and populations (coverage) are involved.

[20] OPTV's reliance on *Pappas Telecasting, Inc.*49 RR 2d 1688 (1981) is misplaced. See Br. Bur. Reply filed June 4, 1982 at para. 6.

[21] Note however that comparative findings of fact have been made (Findings 20–48 *supra.*). It is only comparative conclusions that aren't necessary. See *Edina Corp.*, 45 FCC 796 (1963) at para, 4; *WFPG, Inc.*, 33 FCC 673 (1962) at para. 13; and *Sayger Broadcasting Co.*, 32 FCC 496 at Footnote.

integration credit (which is enhanced by minority and female participation) substantially exceeds OPTV 20% credit. Compare Findings 26–38 with Findings 39–43 *supra*. While OPTV would be entitled to a slight preference for its auxiliary power proposal, it's purported comparative coverage advantage would be obtained at the expense of the short-spacing violation. So any coverage advantage accruing to OPTV is illusory. The net result would be that Clay is an easy comparative winner.

So, unless an appeal is taken from this Initial Decision or the Commission reviews it on its own motion, Clay Television, Inc.'s application (BPCT-801010KE) IS GRANTED; and Orange Park Florida T.V. Inc.'s application (BPCT-801229KK) IS DENIED.[22]

FEDERAL COMMUNICATIONS COMMISSION
WALTER C. MILLER, *Administrative Law Judge*

[22] Ordinarily, if exceptions aren't filed within 30 days, and the Commission doesn't review the case on its own motion, the Initial Decision becomes effective 50 days after its public release. See 47 CFR 1.276(d). But, as previously noted in Footnote 2 *supra*, OPTV has asked that FCC 82–417 released September 21, 1982 be reconsidered. So under 47 CFR 1.291(d) this Initial Decision can't become effective until that pleading is ruled on.

FCC 82D–49

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Applications of	
CLAY TELEVISION, INC. Orange Park, Florida	BC Docket No. 81–690 File No. BPCT-801010KE
ORANGE PARK FLORIDA T.V., INC. Orange Park, Florida	BC Docket No. 81–692 File No. BPCT-801229KK
For Construction Permit	

Appearances

Thomas L. Root on behalf of Clay Television, Inc.; *John R. Feore, Jr.*, *Michael A. Pace*, and *Alan C. Campbell* on behalf of Orange Park Florida T.V., Inc.; and *Norman Goldstein* on behalf of Chief, Broadcast Bureau, Federal Communications Commission.

INITIAL DECISION OF ADMINISTRATIVE LAW JUDGE WALTER C. MILLER

(Issued: June 24, 1982; Released: June 29, 1982)

Preliminary Statement

1. This is a mutually-exclusive contest for a construction permit to operate a new commercial television station on Channel 25, Orange Park, Florida. Two applicants remain:[1] Clay Television, Inc. (Clay) and Orange Park Florida T.V., Inc. (OPTV).

2. The case was designated for hearing on October 2, 1981 (46 FR 50600, published October 14, 1981). After the interlocutory pleading cycle was completed,[2] the following issues remained for resolution:[3]

(1) To determine with respect to Orange Park T.V., Inc., whether, operating as proposed, the potential interference would be insignificant, and, if so,

[1] A third application - that of Christian Communications of Clay, Inc. (BPCT-801229KH) - was dismissed March 2, 1982. See FCC 82M-0673.

[2] The pertinent enlargement and summary rulings were: (1) FCC 81M-3803 released December 2, 1981; (2) FCC 81M-3829 released December 4, 1981; (3) FCC 81M-3832 released December 4, 1981; (4) FCC 81M-3897 released December 10, 1981; (5) FCC 81M-4016 released December 18, 1981; and FCC 82M-0697 released March 3, 1982.

[3] For clarity and organizational purposes the issues have been renumbered.

whether circumstances exist which would warrant a waiver of Section 73.610 of the Commission's Rules.

(2) To determine whether Clay Television, Inc.'s application complies with Section 73.3572 of the Commission's Rules and in the light of the evidence adduced, whether Clay's application should be dismissed.[4]

(3) To determine on a comparative basis, which of the applicants would better serve the public interest, convenience, and necessity. In connection with Issue 3, to determine the areas and populations which would receive primary television service (Grade B or better) from each of the applicants and the other primary television service available to such areas and populations.

(4) To determine, in light of the evidence adduced pursuant to the foregoing issues, which (if either) of the applications should be granted.

3. The burden of proceeding and the burden of proof under Issue 1 is on OPTV; on Issue 2 the burdens are on Clay; and on Issues 3–4 on each of the applicants.

4. The prehearing conference was held on January 8, 1982. Hearings were held on March 16 and 17, 1982, and the record was ultimately closed on March 22, 1982 (see FCC 82M-0929). The two applicants and the Bureau filed their Proposed Findings of Fact and Conclusions of Law on May 21, 1982, and their Reply Findings on June 4, 1982.

Issue 1 - OPTV's Short-Spacing Issue

5. On August 11, 1980, several months before OPTV even decided to file an application for Orange Park, another applicant in another proceeding, Life Style, Inc. (Life Style), applied for an adjacent TV channel in Daytona Beach, Florida.

6. OPTV decided to file its Orange Park application (BPCT-801229KK) in November, 1980.[5] At that time it sent its then consulting engineer to the community to locate a tower and transmitter site. It instructed that engineer to select a site which would provide a city-grade contour over Orange Park, provide maximum area and population coverage and still comply with all FCC and FAA regulations.

7. At that time OPTV's engineer wasn't aware that Life Style had filed an adjacent channel application for Daytona Beach. Consequently, he determined that OPTV could maximize its coverage if it proposed a tower with a height above average terrain of more than 950 feet. However, he also recognized that this 950 foot plus constraint would limit the possible tower locations to a very

[4] This basic qualifying issue was added on December 10, 1981 (FCC 81M-3897). But Clay was given permission to appeal the enlargement ruling. See FCC 81M-3990 released December 17, 1981. That appeal was filed and is still pending.

[5] Clay Television, Inc. had already filed its application (BPCT-801010KE) the previous month; i.e., on October 10, 1980. So OPTV was aware that if it filed for Orange Park it faced a potential competitive hearing.

small area because of FAA restrictions and the amount of land required for guying so tall a tower.[6]

8. The consulting engineer located and recommended what he thought was a potential site that met all the requirements. That is the only site he considered. That is the site on which OPTV has obtained an option and proposes to locate its tower and transmitter (described in para. 9 *infra.*).

9. On December 29, 1980 (the cut-off date), OPTV filed its application. It proposed to locate its tower at a site near Penney Farms, Florida. The tower would be 954 feet above the ground and 1,049 feet above mean sea level. However, the site OPTV has selected is only 52.36 miles from the earlier-filed Life Style proposed site. So OPTV's proposed site is short-spaced by 2.64 miles[7] and can't be granted without a waiver of 47 CFR 73.610.[8]

10. This led the Commission to designate the short-spacing issue involved here (see para. 2). And in the designation order it called on OPTV to make two showings. First the Commission expressly called on OPTV to show whether the potential interference was significant or not. And if the amount of interference proved significant then the Commission called on OPTV to show that circumstances exist which would warrant waiving the 47 CFR 73.610 violation. See 47 FR 50600 *supra.*

11. Until the designation order was issued on October 2, 1981, OPTV remained unaware that its application was short-spaced with Life Style's.[9] Shortly after designation it retained a new consulting engineer, John J. Mullaney (Tr. 227–229, 233, 240).

12. Mullaney looked over the short-spaced situation. He decided that there were two alternatives: (1) OPTV could move into an area that would comply with 47 CFR 73.610; or (2) stay at the present location and take a chance on whether or not waiver will be granted (Tr. 250–251).

13. Mullaney recommended the second alternative. He felt a change of location would be unwise because of the possibility that the FAA wouldn't issue a no hazard determination until OPTV reduced its tower height significantly. This tower height reduction, in turn, would reduce the area and population served. OPTV adopted Mullaney's recommendation. It decided to "Stick it out." Conse-

[6] The site was selected contemplating 70% guying (the industry guying standard) and thus required 20 acres. Only about 15.6 acres would be needed for 50% guying, but this would increase the cost of the tower.

[7] At one time OPTV's proposed site was short-spaced with Life Style's by 5.5 miles. However, Life Style has subsequently reduced the amount of short-spacing by amending its application (Tr. 270).

[8] 47 CFR 73.610 requires a minimum separation of 55 miles between adjacent channel UHF television stations.

[9] OPTV even went ahead, on December 23, 1980 and applied for a no hazard determination with the FAA. A determination of no hazard for the site was issued on September 16, 1981 (Clay Ex. 11, p. 1).

quently, it didn't consider a site change (Tr. 233–234, 250–252, 290–291, 332–337, and 423–424).[10]

14. It wasn't until he prepared his testimony that Mullaney determined the triangular area where a tower could be located without requiring a waiver of the rules. Both Clay, who had filed earlier (see Footnote 5 *supra.*) and Christian (see Footnote 1 *supra.*) had specified sites within that triangular area (OPTV Ex. 7, p. 5).

15. At the hearing OPTV made no attempt to meet the first part of designated short-spacing issue. Mullaney made no attempt to determine whether the interference was significant or not (see Finding 10 *supra.*). He didn't calculate the size of its affected area or its population. In fact he never even considered such a calculation (Tr. 270–272).

16. Instead Mullaney relied on a showing that equivalent protection would be provided to Life Style (Tr. 262, 267–268, 304–307). That analysis showed that if OPTV could find a properly spaced site, using an antenna whose HAAT was 2,000 feet,[11] it would create significantly more interference than would its presently proposed operation (Tr. 274).

17. Although he made no effort to calculate the interference caused by the short-spacing (Finding 15 *supra.*), Mullaney offered certain opinions about such interference as it relates to his equivalent protection contention. He speculates that the interference would only be about 1 to 1 1;2 miles deep at its maximum;[12] and that it would occur in a rural area; i.e., one that doesn't contain any large cities (Tr. 290, 312, 341). Based on those non-documented contentions, Mullaney then concludes that the area of potential interference is insignificant when compared with his interpretation of what the rules would allow (Tr. 310–314).

18. OPTV also hired an aeronautical consultant, N. Stanley Kingham, to testify in this case. He testified on whether a 1,000 foot tower on a site in the approved triangular area (see Finding 14 *supra.*) would be approved by the FAA.[13] It was his opinion that the FAA would find a 1,000 foot tower in the triangular area a hazard to air navigation; he further opined that a request for approval of a tower between 300 and 1,000 feet in height would require a closer look and would possibly be approved. In fact he gave the opinion that a 749 foot tower in the triangular area would have a fifty-fifty

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[10] Because OPTV has decided to proceed with its original site, Mullaney has never reviewed OPTV's site requirements or land availability.

[11] With its proposed 5 kW power this would then represent a maximum permissible facility (§ 73.614(b)).

[12] Of course, since OPTV made no engineering calculations there is no evidence on over what arc this interference would occur.

[13] The FAA doesn't issue declaratory rulings. A specific proposal must be submitted to it (Tr. 334).

chance of receiving air hazard clearance (OPTV Exs. 7–8; Tr. 445–462).[14] [15]

Issue 2 - Clay's 73.3572 Issue[16]

19. Clay filed its application on October 10, 1980. There the following five ownership percentages were shown:

Charles Fellows	– 12.5%
Richard Fellows	– 12.5%
Napoleon Leano	– 25.0%
William Bazley	– 25.0%
W. Raleigh Thompson	– 25.0%

20. On December 29, 1980,[17] Clay amended its application to show six owners with the following ownership percentages:

Charles Fellows	– 12.5%
Richard Fellows	– 12.5%
Napoleon Leano	– 24.0%
William Bazley	– 1.0%
W. Raleigh Thompson	– 24.0%
Joan Bazley	– 26.0%

21. So, as of December 29, 1980, Clay had gone through a 26% net ownership change. William Bazley had transferred 24% of his stock and Napoleon Leano and W. Raleigh Thompson had each transferred 1% of their stock to Joan Bazley, a new stockholder.

22. On April 2, 1981,[18] Clay amended its application again. This time it showed eight owners with the following ownership percentages.

Charles Fellows	– 12.5%
Richard Fellows	– 12.5%
Napoleon Leano	– 12.0%

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[14] Clay's counsel cross-examined Kingham at some length on the basis of his opinion without seriously undermining his opinions (Tr. 357–443; 466–468).

[15] OPTV also contends that its superior coverage position vis-a-vis Clay should be considered in determining whether to grant it a waiver of its 47 CFR 73.610 violation. This contention is rejected. Any areas and population advantage that OPTV may have will be considered under the standard comparative issue. That is Commission policy. OPTV cannot be permitted to "double-count" any comparative advantage it may have.

[16] As previously noted (Footnote 4), this issue was added on December 10, 1981 (FCC 81M-3897), but Clay was given permission to appeal the enlargement ruling shortly thereafter (see FCC 81M-3990 released December 17, 1981), so that we'd have some guidance on how to proceed. But the appeal is still pending. So the Presiding Officer is going ahead without such guidance. Undoubtedly such guidance will be available when the case reaches the Review Board level.

[17] The Commission established December 29, 1980 as the A cut-off date. See 45 FR 76790 published November 20, 1980.

[18] The Commission established April 2, 1981 as the B cut-off date (Mimeo 07030 Report No. B-18).

William Bazley	- 1.0%
W. Raleigh Thompson	- 12.0%
Joan Bazley	- 26.0%
Joanne Thompson	- 12.0%
Leonora Leano	- 12.0%

23. So, as of April 2, 1981, Clay now had undergone a further 24% ownership change. It showed two new 12% stockholders; i.e., Joanne Thompson and Leonora Leano, while Napoleon Leano's and W. Raleigh Thompson's former 24% interests had decreased to 12% each.

24. Thus between the date Clay filed its application (October 10, 1980) and the B cut-off list (April 2, 1981), it had effected a 50% change in its stock ownership. Subsequently, Clay reported that all its eight shareholders had paid their stock subscriptions reflecting the stock ownership percentage reported in its April 2, 1981 amendment (FCC 82M-0695, released March 3, 1982).[19]

Issue 3 - The Standard Comparative Issue

25. *Description of Applicants - Clay.* Clay Television, a Florida corporation, was formed in 1978. It is authorized 7500 shares but only 800 have been issued. The following chart sets out the details on Clay's officers directors, and/or stockholders:

Clay

Person	*Ownership Percentage*	*Office*	*Director*
Charles R. Fellows	12.5%	President	Yes
Richard C. Fellows	12.5%	_____	Yes
Joan J. Bazley	26.0%	Secretary	Yes
Joanne Thompson	12.0%	Vice-President	Yes
Leonora Leano	12.0%	Treasurer	Yes
William Bazley	1.0%	_____	—
W. Raleigh Thompson	12.0%	_____	—
Napoleon Leano	12.0%	_____	—

26. *Orange Park Florida T.V. Inc.* Orange Park, a Delaware Corporation is authorized 1250 shares of common stock. 1000 of those shares have been issued, and 250 shares have been subscribed. The following chart sets out the details on OPTV's officers, directors, and/or stockholders:

[19] In the Order adding the 73.3572 issue (FCC 81M-3897, released December 10, 1981), Clay was afforded the opportunity to avoid the thrust of that issue simply by withdrawing its April 2, 1981 amendment. It elected not to do so. See paragraph 11 of that Order. Thus a decision must be reached on the 50% ownership transfer question.

OPTV

Person	*Ownership Percentage*	*Office*	*Director*
Malcom I. Glazer	80%	President	Yes
Robert J. McCullough	20%	Vice-President	No
Carl Brasley	—	Secretary-President	No
James A. Underwood	—	Vice-President	No
David Murphy	—	Vice-President	No

27. *Diversification of Mass Media - Clay.* Neither Clay nor any of its eight principals have any ownership interest in any other broadcast station, cable television system, newspaper or other mass communications medium.

28. *OPTV.* OPTV has no ownership in any broadcast station or other mass communications medium. However, several of OPTV's principals have such interests. *Malcolm I. Glazer* is the President, Director and sole stockholder of the licensee corporations of WTWO-TV, Terre Haute, Indiana; KQTV (TV), St. Joseph, Missouri; and WRBL (TV), Columbus, Georgia.[20] He is also President, Director and possesses interests in the following:

Additional Glazer Interests

Entity and Interest	*Percentage of Ownership*
Irving Texas T.V. Inc., applicant for a new commercial UHF TV Station, Irving, Texas	80%
Toledo, Ohio, T.V. Inc., applicant for a new commercial UHF TV Station, Toledo, Ohio	80%[21]
Knoxville, Tennessee, T.V. Inc., applicant for a new commercial UHF TV Station, Knoxville, Tennessee	51%
Hammond, Indiana T.V. Inc., applicant for a new commercial UHF TV Station, Hammond, Indiana	51%
Salt Lake City T.V. Inc., applicant for a new commercial UHF TV Station, Salt Lake City, Utah.	51%
TV American Corporation, application for LPTV Stations in (1) Terrre Haute, Indiana; (2), Portland, Oregon; (3) Columbus, Georgia; and (4) Baltimore, Maryland	100%

29. *Carl Brasley* is Secretary-Treasurer of KQTV (TV), St. Joseph, Missouri; Assistant Secretary and Director of WTWO-TV, Terre Haute, Indiana; Secretary-Treasurer and Director of WRBL (TV); and Secretary-Treasurer of the applicants listed on the paragraph 28 chart.

[20] WRBL (TV) is located about 265 air miles from Orange Park; WTWO-TV is about 715 miles away; and KQTV (TV) is 975 miles away.

[21] Toledo Ohio T.V. Inc. has entered into a settlement agreement to dismiss its UHF application in return for reimbursement of the expenses it incurred prosecuting its application. See FCC 82M-1880 released June 16, 1982.

30. *James Underwood* is Executive Vice President, Director, and General Manager of WRBL (TV), Columbus, Georgia. *David Murphy* is Operations Manager at the same station.

31. *Integration of Ownership With Management - Clay.*[22] Clay seeks 50% integration credit. It intends to integrate three of its eight stockholders.

32. Clay will fully integrate its Secretary, Director, and 26% stockholder, *Joan Bazley*, into its day-to-day operation. Mrs. Bazley will be the full-time Public Affairs Director of the proposed station. In that capacity she will be responsible for producing the public affairs schedule. She will select the participants and topics to be treated by public affairs programming; she'll maintain contact with Orange Park and Clay County citizens to ascertain public affairs problems; and she'll participate with the other principals in setting the program policies of the station.

33. Joan Bazley was born in Schenectady, New York in 1944. She graduated from the Jackson Memorial Hospital School of Nursing, Miami, Florida. She and her family have resided in Green Cove Springs since 1972. Green Cove Springs is in Clay County - about 12 miles south of Orange Park.

34. Since 1975 Mrs. Bazley has been employed part-time for her husband William S. Bazley, M.D. Her duties include bookkeeping and investment control for pension plans and similar accounts for the professional corporation. If Clay is granted a CP, she'll resign this position. From June 1977 to April 1981 she was also the owner of a retail store that specialized in the sale of hand-crafted items. She liquidated her inventory and closed the store in April, 1981.

35. Mrs. Bazley has no broadcast experience. She has never worked in a television station and has never been involved in television programming production. Most of her civic activities aren't directly concerned with Orange Park - the proposed city of license. However, for the past five years she has been a member of the Friends of the Orange Park Library (Clay Ex. 2; Tr. 113–140).

36. Next Clay will fully integrate its Vice-President, Director, and 12% stockholder, *Joanne Thompson*, into the station's day-to-day operation. She will be Clay's full-time (at least 40 hours per week) continuity/community affairs director. In that capacity she'll review programming material to see that it meets station standards. She'll also be responsible for producing the station's educational programming; she'll maintain contact with the area schools, collect information for public service announcements and solicit educational problems, topics and activities.

37. Joanne Thompson was born and raised in Jacksonville,

[22] Clay's integration proposal is being analyzed on the basis of its April 2, 1981 amendment (paras. 22–23 *supra.*). So if the Commission acts favorably on Clay's appeal this integration-of-ownership-with-management analysis is relevant, but if the Commission denies Clay's appeal it will be irrelevant.

Florida. She and her husband have resided in Orange Park since 1967. She hasn't been employed for the past 25 years.

38. Mrs. Thompson has no broadcast experience. But she has studied broadcasting books to familiarize herself with television broadcasting.

39. She has been a member of the Grace Episcopal Church in Orange Park since 1967. She has been active in church activities; e.g. she taught Sunday School for five years. She has been a member of the Friends of the Orange Park Library for five years and a member of the Clay County Medical Society Auxiliary since 1975. She is also a member of the Orange Park Garden Club and has been since 1967; and she is a Saber Club member - an auxiliary of the Shrine - and as such helps out in fund-raising for aiding crippled children (Clay Ex. 6; Tr. 145–158).

40. Finally, Clay will fully integrate its Treasurer, Director, and 12% stockholder, *Leonora Leano*, into the station's day-to-day operation. Mrs. Leano will be Clay's full-time (minimum of 40 hours weekly) director of minority and children's programming. In that capacity she will be responsible for coordinating and producing children's programs and programs of concern to minority groups (Tr. 170–177; Clay Ex. 7, p. 4).

41. Mrs. Leano is an Asian American. She was born in the Phillipines and obtained her medical degree there. She has completed her medical residency in 1971. She practiced medicine from 1978 to 1979, specializing in pediatrics. She left medical practice in 1979 and doesn't propose to resume it—even on a part-time basis. She'd rather work in television because the regular hours of her position at the television station would permit her time with her family.[23] She may work hours of 8:00 a.m. to 3 p.m. during the week, with extra hours in the evening or on the weekend to fulfill her 40 hour commitment (Tr. 177).

42. She and her family have lived in Orange Park since 1976.

43. Leonora Leano has no broadcast experience and has never even been inside a television station (Tr. 177). She is a member of the Greater Orange Park Community Hospital medical staff; the Clay County Medical Society Auxiliary; the St. Catherine Catholic Church; and the Parents-Teachers League of St. John's Country Day School (Clay Ex. 7).

44. *OPTV.* OPTV seeks 20% integration credit. It intends to integrate one of its stockholders.

45. OPTV will fully integrate its Vice-President, and 20% stockholder, *Robert McCullough*, into its proposed day-to-day operations. McCullough will be the station's full-time General Manager

[23] Mrs. Leano isn't concerned about how much money she was making as a pediatrician or how much she'll make as Clay's director of minority and children's programming. Her husband is a physician specializing in anesthesiology, and makes a sufficient income (Tr. 173–176, 191).

and will devote a minimum of 40 hours a week to the station's operations. In his capacity of General Manager, McCullough will direct all aspects of the station's operations including programming, sales, promotion and engineering. All department heads and managerial employees will report to him. He will establish the station's policies and practices and be primarily responsible for EEO and personnel decisions.

46. Robert McCullough was born and raised in Stamford, Connecticut. He currently resides in Stamford but will move his family to Clay County if OPTV's application is granted (Tr. 211). From 1947 through 1951 McCullough attended the University of Bridgeport; he majored in sales and advertising. He served in the Navy for two years and was honorably discharged.

47. McCullough worked for the Stamford *Advocate* newspaper from 1953 to 1959. From 1959 to 1970 he was employed by the Greenwich *Time* newspaper. He started with the *Time* as the Classified Advertising Manager; then he became Business Manager; and finally he became General Manager.

48. From November 27, 1970 until March 11, 1982, when the stations were sold, he was General Manager of Stations WSTC and WYRS (FM), Stamford, Connecticut (OPTV Ex. 4). McCullough has never been to Orange Park or Clay County, Florida (Tr. 211–212).

49. *Auxiliary Power.* OPTV proposes to install and maintain an auxiliary power generator to assure the station's continuous operation if the power fails. This auxiliary generator will have automatic starting features. Clay doesn't propose to use auxiliary power generating equipment.

50. *Comparative Coverage.* Both applicants seek a UHF CP for Channel 25, Orange Park, Florida. Orange Park, located in Clay County, is about 11 miles south of Jacksonville, Florida. No television stations are licensed to Orange Park.

51. Clay proposes an antenna whose height above average terrain is 496 feet and an ERP of 2,060 kW. OPTV proposes an antenna whose HAAT is 954 feet and an ERP of 5,000 kW.

52. Because they propose different powers, antenna heights and site locations, their proposed Grade B primary service contours would embrace different areas and populations. OPTV's proposed primary service contour completely encompasses Clay's.[24] The following chart shows the primary service picture:

Primary Service

Applicant	*Area (sq. mi.)*	*Population*
Clay	3,307	620,896
OPTV	6,094	751,818

[24] It must be remembered that Clay has secured at least part of its areas and populations advantage at the price of a short-spacing violation. See Findings 5–19 *supra.*

Applicant	*Area (sq. mi.)*	*Population*
OPTV's advantage	2,787 (84.3%)	130,922 (21.1%)

53. In addition, and since OPTV's contour embraces Clay's there are underserved areas and populations that OPTV will serve that Clay doesn't. In fact OPTV would serve a TV grey area that Clay wouldn't. The following chart shows OPTV's exclusive service:

OPTV's Exclusively Served Areas

Area (sq. mi.)	*Population*	*Number of Existing Services*
68	3,150	1
276	55,980	2
209	16,661	3

Ultimate Findings and Preliminary Conclusions

1. Orange Park Florida T.V., Inc. (OPTV) and Clay Television, Inc. (Clay) each seek authority to operate a new UHF station on Channel 25, Orange Park, Florida.

2. Three issues need to be resolved. Each applicant faces a basic qualifying issue and there is the standard comparative issue. OPTV faces a 47 CFR 73.610 (short-spacing) violation issue; and Clay must cope with a 47 CFR 73.3572 transfer of control issue.

3. The two basic qualifying issues must be resolved first. For it is axiomatic that only basically qualified applicants are entitled to comparative consideration. See e.g. *Louis Adelman*, 29 FCC 1223, 18 RR 1062 (1960), *affirmed sub. nom. Guinan v. Federal Communications Commission*, 297 F.2d 782, 22 RR 2026 (1961).

OPTV's Short-Spacing Issue

4. 47 CFR 73.610 requires a minimum separation of 55 miles between adjacent channel UHF television stations. OPTV proposes a site that is 52.36 miles from Life Style Broadcasting, Inc.'s adjacent channel Daytona Beach, Florida site. So OPTV violates § 73.610; it's short-spaced by over 2 1/2 miles.[25]

5. OPTV has been aware of its short-spacing problem since shortly after the designation order was issued on October 2, 1981. At that time it changed consulting engineers and hired John J. Mullaney to study the problem. Mullaney told OPTV not to amend to a site that would comply with 47 CFR 73.610. Instead he advised OPTV to gamble that it could obtain a waiver of the violation. Mullaney didn't want to have to reduce the height of the 954 foot tower because that would result in a loss of OPTV's areas and

[25] As previously noted (Footnote 12 *supra.*) the interference area is 2 1/2 miles deep. The record doesn't reflect the length of the interference or over what area it would extend since OPTV's consulting engineer didn't calculate it.

populations. So he told OPTV to "stick it out." OPTV followed that advice.

6. Under the terms of the designated issue, and if it was to meet its burdens of proceeding and proof, OPTV was obligated to make two showings. First it had to show whether the interference resulting from the short-spacing was significant or not. Then, if the interference proved significant, OPTV was to demonstrate that circumstances exist that would warrant waiving a 73.610 violation of that magnitude.

7. OPTV has failed to meet the short-spacing issue, and its application must be denied. First of all it failed to show whether the short-spaced interference was significant or not. It produced no evidence on the areas and populations which would be subject to interference because of its deliberate short-spacing. Mullaney not only never calculated the interference he never even considered making such a calculation. So OPTV has failed to sustain its burden of proceeding on Issue 1 and its application must be denied.[26]

8. Mullaney asserts that he didn't need to determine whether the short-spaced interference is significant or not since he would address the problem on the basis of "equivalent protection." That assertion is rejected. The Broadcast Bureau is right. The "equivalent protection" rationale hasn't been extended to UHF service. See *Carolina Christian Broadcasting, Inc.*, 48 RR 2d 355 (1980) at 358.[27]

9. Secondly, and even *assuming* that OPTV had shown the nature and extent of the short-spaced interference it would still not be entitled to a waiver of its § 73.610 violation. It has failed to make the threshold showing that suitable non-short-spaced sites aren't available. See *Townsend Broadcasting Corporation*, 62 FCC 2d 511 (1976) at 512.

10. Indeed it is impossible for OPTV to show that non-short-spaced sites are unavailable. The records shows that Clay's proposed site and the site formerly proposed by Christian Communications of Clay, Inc. (see Footnote 1 *supra.*) both meet 47 CFR 73.610's spacing requirements. The record further shows that there is another additional area where an antenna could be located that would comply with § 73.610.

11. The situation is clear. OPTV was interested in its antenna height and extended coverage more than it was in correcting its 47 CFR 73.610 violation. It was well aware the violation existed. It knew sites were available that would cure the violation. But it didn't

[26] Mullaney belatedly, at the hearing, tried to argue that the short-spaced interference was minor. This belated argument won't be credited. It cannot be considered a surrogate for the detail that the Commission is entitled to when areas and populations (coverage) are involved.

[27] OPTV's reliance on *Pappas Telecasting, Inc.*, 49 RR 2d 1688 (1981) is misplaced. See Br. Bur. Reply filed June 4, 1982 at para. 6.

bother looking for such a site. This forms a second and independent reason for denying OPTV's application. It is therefore concluded that OPTV isn't technically qualified to be a Commission licensee.

Clay 47 CFR 73.3572 Issue

12. Under Issue 2, we must determine whether Clay's application, as amended complies with 47 CFR 73.3572 and, if so, whether that application should be dismissed.

13. The record evidence (Findings 19–24 supra.), when read in the light of existing Commission precedent, indicates that Clay has effected a major change in its application.[28] The December 29, 1980, 26% net ownership change when coupled with the April 2, 1981 24% ownership change clearly resulted in a transfer of control; i.e., a transfer of a 50% interest (negative control).[29]

14. This, in turn, triggered the application of 47 CFR 73.3572(b) which specifically states that a transfer of control "by a series of amendments" requires the assignment of a new file number. See *Certified Communications, Inc.*, 44 RR 2d 708 (1978); and 47 CFR 73.3572(b).

15. Thus, 47 CFR 73.3572 requires that Clay's application be returned to the processing line and it becomes ineligible for comparative consideration with OPTV in this proceeding.[30]

Final Conclusion

16. There is no need for an analysis under the standard comparative issue.[31] Under 47 CFR 73.3572 Clay isn't eligible for comparative consideration, and OPTV isn't basically qualified to be a Commission licensee. It isn't technically qualified. So there is nothing to compare.

17. A parting word is warranted. It's unfortunate we've gone through a proceeding without an applicant being granted. The citizens of Orange Park are temporarily deprived of a Channel 25 UHF applicant. However, the situation isn't as bad as it seems. Orange Park is an integral part of the Jacksonville, Florida

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[28] *Clay Broadcasters, Inc.*, 21 RR 2d 442 (1972); *Grace Missionary Baptist Church*, 80 FCC 2d 330 (1980); and 47 CFR 73.3615(c)(5).

[29] Clay was offered the chance to withdraw its April 2, 1981 amendment. See FCC 81M-3897 released December 10, 1981. It refused to do so. It should be noted that had it done so, the comparative integration-of-ownership-with-management picture would be substantially different. See Findings 31–43 *supra*.

[30] However, if the Commission grants Clay's 73.3572 appeal, then Clay's application can be granted since it would be the only qualified applicant. See Conclusions paras. 4–11 *supra*.

[31] Note however that comparative findings of fact have been made (Findings paras. 25–53 *supra*.). It is only comparative conclusions that aren't necessary. See *Edina Corp.*, 45 FCC 796 (1963) at para. 4; *WFPG, Inc.* 33 FCC 673 (1962) at para. 13; and *Sayger Broadcasting Co.*, 32 FCC 496 at Footnote 7.

urbanized area. And there are five television stations licensed to Jacksonville (OPTV Ex. 6, p. 9). So no real harm is done by waiting for an applicant who meets the Commission's minimum standards to operate UHF Channel 25.

SO, unless an appeal is taken from this Initial Decision or the Commission reviews it on its own motion, Orange Park Florida T.V. Inc.'s application (BPCT-801229KK) IS DENIED; and Clay Television, Inc.'s application (BPCT-801010KE) IS RETURNED to the Television Service Processing Line.[32]

FEDERAL COMMUNICATIONS COMMISSION
WALTER C. MILLER, *Administrative Law Judge*

[32] Ordinarily, if exceptions aren't filed within 30 days, and the Commission doesn't review the case on its own motion, the Initial Decision becomes effective 50 days after its public release. See 47 CFR 1.276(d). But, as previously noted (see Footnote 4 *supra.*), Clay has an appeal of FCC 81M-3897 released December 10, 1981 pending before the Commission. So under 47 CFR 1.291(d) this Initial Decision cannot become effective until after that interlocutory matter is ruled on.

CATV Registration Procedure
Forfeiture Mitigation, Request For Denied
Review Application For

Application for review of denial of request for mitigation of forfeiture denied. Cable system's failure to register signals carried incurred liability in accord with Commission precedent. –*Clearview Cable TV, Inc.*

FCC 83–521

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re:	
LIABILITY OF CLEAR-VIEW CABLE TV, INC.	
Pearisburg, Virginia	VA0189
Narrows, Virginia	VA0190
Giles County, Virginia	VA0192
Giles County, Virginia	VA0193
Application for Review	

MEMORANDUM OPINION AND ORDER

(Adopted: November 8, 1983; Released: November 16, 1983)

BY THE COMMISSION: COMMISSIONER RIVERA ABSENT.

1. On May 23, 1983, Clear-View Cable TV, Inc. (hereinafter "Clear-View"), operator of cable television systems serving Pearisburg, Narrows, and unincorporated areas of Giles County, Virginia filed an "Application for Review" of the decision of the Chief of the Mass Media Bureau in *Liability of Clear-View Cable TV, Inc.* (Pearisburg, Virginia), Mimeo No. 3748, ___ RR 2d ___ (1983). Therein the Bureau Chief, pursuant to delegated authority, denied Clear-View's request for mitigation of the $1,000 forfeiture assessed against it for willful or repeated violations of Section 76.12 of the Commission's Rules. *See In re Clear-View Cable TV, Inc.* (Pearisburg, Virginia), Cable Television Action Report No. 2686, Mimeo No. 1203 (released December 7, 1982).

2. The notice of apparent liability in the amount of $1,000 was issued because Clear-View carried Stations WGN-TV (Ind., Channel 9), Chicago, Illinois; WOR-TV (Ind., Channel 9), Secaucus, New Jersey; and WTBS-TV (Ind., Channel 17), Atlanta, Georgia, on its

cable television system without prior registration of such carriage, in violation of 76.12 of the Commission's Rules, for a period from January 11, 1982 until November 30, 1982. Clear-View did not admit these violations, however, until after their discovery by a Field Operations Bureau investigation during the week of January 11, 1982. In seeking mitigation, Clear-View contended: (1) that the failure to register carriage of the aforementioned signals was an oversight; (2) that its compliance has remedied any of the problems existing in the past; and (3) that a $1,000 fine is greater than necessary to cause remedial action in as small a cable television system as Clear-View. However, the Bureau Chief noted: (1) that it is well settled that corrective action will not excuse past violations; (2) that cable television systems regardless of their size, are expected to be familiar with and to comply with the Commission's rules; and (3) that Clear-View failed to introduce any showing establishing that the $1,000 forfeiture is excessive in light of its financial position. Accordingly, the Bureau Chief denied Clear-View's request for mitigation. *Liability of Clear-View Cable TV, Inc., supra.*

3. In seeking review of the Bureau Chief's decision, Clear-View contends that the decision is contrary to Commission precedent and policy, and that the decision is based, in part, on "an erroneous finding as to a material question of fact." Clear-View acknowledges its failure to register the cited signals for carriage, but contends that a $1,000 fine for these violations is far too large in view of the nature of the violations. In addition, Clear-View states that the FOB investigation cited by the Bureau Chief did not occur until late in 1982, whereupon the notice of apparent liability dated November 30, 1982, was issued and "Clear-View promptly corrected the violation. . ."

4. Contrary to Clear-View's assertions, FOB records clearly indicate that the cited investigation occurred in January 1982.[1] In addition, the forfeiture assessed against it for failing to register three signals for nearly one year comports with Commission precedent in this area. *See, e.g., In re Jackson Cable Systems* (Lewisburg, Ohio), Cable Television Action Report No. 2647, Mimeo No. 5567 (released August 3, 1982), *aff'd*, Mimeo No. 019, ___ RR 2d ___ (1982) ($500 forfeiture for failure to register one signal for two years); *In re Manhattan Cable Television, Inc.* (New York, New York) (adopted May 22, 1980) ($250 forfeiture for failure to register one signal for four months). Accordingly, we find that the Bureau Chief did not err in his decision.

5. In view of the foregoing, we find that grant of Clear-View's "Application for Review" is not in the public interest.

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[1] This was an on-site investigation of signal leakage in Narrows, Virginia, during the week of January 11–15, 1982. This investigation also revealed the carriage of the cited unregistered signals. The results of the investigation were mailed to Clear-View on January 27, 1982.

6. Accordingly, IT IS ORDERED, pursuant to Section 503(b) of the Communications Act of 1934, as amended, and Section 1.80(f) of the Commission's Rules, That Clear-View Cable TV, Inc. FORFEIT to the United States the sum of one thousand dollars ($1,000) for repeated violations of Section 76.12 of the Commission's Rules. Payment of the forfeiture may be made by mailing the Commission a check or similar instrument drawn to the order of the Federal Communications Commission. If this forfeiture is not paid within thirty (30) days of the release date of this Memorandum Opinion and Order, the case will be referred to the Department of Justice for collection, pursuant to Section 504(a) of the Communications Act, as amended.

7. IT IS FURTHER ORDERED, That a copy of this Memorandum Opinion and Order shall be sent by Certified Mail - Return Receipt Requested to Clear-View Cable TV, Inc.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

CATV Jurisdiction Over, By Local Municipality
CATV Jurisdiction Over, By State Authority
Declaratory Ruling

Request for issuance of a declaratory ruling granted. Commission has preempted state and local rate regulation of tiered services offered to cable subscribers.
–Community Cable TV, Inc.

FCC 83–525

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re:	
COMMUNITY CABLE TV, INC.	CSR-2269
Petition for Special Relief	

MEMORANDUM OPINION AND ORDER

(Adopted: November 8, 1983; Released: November 15, 1983)

BY THE COMMISSION: COMMISSIONER RIVERA ABSENT.

Introduction

1. On February 3, 1983, Community Cable TV, Inc. (hereinafter "CCTV"), operator of a cable television system serving Las Vegas, Nevada, and neighboring communities, filed a "Petition for Special Relief Requesting Declaratory Ruling" concerning the extent of federal preemption of cable television system rate regulation. Specifically, CCTV seeks a ruling that such preemption

> extends not only to pay or subscription cable services (*i.e.*, programming for which a perchannel or per-program charge is made) but also to specialized or auxiliary cable services—primarily satellite-delivered programming—of the kind commonly provided in tiers of services offered to subscribers at a single package rate distinct from the rate charged for regular subscriber services.

Comments on CCTV's petition have been filed by the following parties: Mr. Henry Geller and Ms. Donna Lampert, jointly; the Nevada Public Services Commission (hereinafter "PSC"); A-R Telecommunications (hereinafter "ART"), operator of several cable television systems in the eastern United States; Group W Cable, Inc. (hereinafter "Group W"), operator of several cable television systems across the country, including Reno and Washoe County, Nevada; the City of Dallas, Texas (hereinafter "Dallas"); Nevada Pay Television, Inc. (hereinafter "NPTV"), a distributor of pay television program-

ming in the Las Vegas, Nevada metropolitan area through multipoint distribution service (MDS) and master antenna (MATV) systems; the Cable Television Information Center (hereinafter "CTIC"), "a non-profit organization whose membership includes over 200 city governments . . ."; Capital Cities Cable, Inc. (hereinafter "CCC"), operator of over 40 cable systems in 12 states; the City of Richmond, Indiana, the Town of Front Royal, Virginia, and the Harrisonburg Electric Commission of Harrisonburg, Virginia, jointly (hereinafter "the Cities"); and Time Inc. (hereinafter "Time"), a corporation which, *inter alia*, is developing teletext, and whose subsidiaries include the multiple system operator American Television and Communications Corporation (hereinafter "ATC"), Home Box Office, Inc. (hereinafter "HBO"), Cinemax, and the USA Network (hereinafter "USA").[1] CCTV has replied to these comments, as has the National Cable Television Association, Inc. (hereinafter "NCTA").[2]

2. CCTV seeks its requested ruling as a result of the decision in *In re Proposed General Order No. 40*, Docket No. 82–343 (Nev. Pub. Serv. Comm'n, Nov. 2, 1982). On July 15, 1982, PSC proposed to adopt General Order No. 40 in order to clarify and define the terms and provisions of Nevada's cable television system laws, Nev. Rev. Stat. §§ 711 *et seq*. General Order No. 40 contemplates rate regulation by PSC for all subscriber service, a term defined in Section 2.8 of General Order No. 40 as "all cable television service provided other than pay channel services." Section 2.7 defines pay channel service as "a channel which is individually charged to customers." A public hearing on the PSC proposal was held in Carson City, Nevada, on September 28, 1982, in which CCTV and other parties participated. As a result of this hearing, PSC found, contrary to the position urged by CCTV and other cable television companies (*see In re Proposed General Order No. 40*, slip op. at 4–5), that "[t]he scope of federal preemption over CATV service is necessarily limited to specialized programming for which a per-program or per-channel charge is made . . .." *Id.* at 8. Subsequently, CCTV filed the instant petition.

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[1] By *Order*, Mimeo No. 2735 (released March 4, 1983), a "Motion for Extension of Time" filed February 25, 1983, by CTIC was granted by the Chief of the Video Services Division of the Mass Media Bureau, extending the time for filing oppositions and comments until March 18, 1983, and for filing CCTV's reply until April 7, 1983.

[2] NCTA's reply is contemplated neither by Section 1.45(b) or by Section 76.7(e) of the Commission's Rules, because NCTA is not a petitioner. However, we believe the public interest would be best served by the Commission's full consideration of all the facts and arguments set forth herein. Accordingly, NCTA's reply will be considered.

Summary of CCTV's Petition

3. In support of its petition, CCTV argues that General Order No. 40 would countenance state regulation of rates in a manner which has been preempted by the Commission. CCTV notes particularly that its "expanded tier"—which is distinct from its "basic tier"[3]—includes satellite-delivered services such as Stations WGN-TV (Ind., Channel 9), Chicago, Illinois, WOR-TV (Ind., Channel 9), Secaucus, New Jersey, and WTBS (Ind., Channel 17), Atlanta, Georgia; the Entertainment and Sports Program Network (hereinafter "ESPN"); Cable News Network (hereinafter "CNN"); the Satellite Program Network (hereinafter "SPN"); USA; Music Television (hereinafter "MTV"); Satellite News Channel (hereinafter "SNC"); and the Christian Broadcasting Network (hereinafter "CBN"). In addition, CCTV's "expanded tier" offers a non-satellite-delivered program guide, Community Bulletin Board, and a New York Stock Exchange ticker. Were CCTV to attempt to offer services such as these on a separate, perchannel charge basis, to avoid PSC rate regulation, CCTV notes that services such as MTV and Nickelodeon would no longer be made available to it. CCTV states that a witness employed by the Warner Amex Satellite Entertainment Company (hereinafter "WASEC") testified in the PSC proceedings that WASEC would not distribute MTV and Nickelodeon to cable operators intending to offer these services for a separate, perchannel charge.

4. CCTV reviews the history of the Commission's cable regulatory program, particularly as it affects local rate regulation, and argues that the Commission has preempted "cable television rate regulation for all but regular subscriber services." Citing the *Cable Television Report and Order*, FCC 72–108, 36 FCC 2d 143 (1972) [hereinafter "*CTRO*"], *recon. granted in part*, FCC 72–530, 36 FCC 2d 326 (1972), CCTV contends that the Commission intended that local rate regulation not extend beyond services furnished to all subscribers. These regular subscriber services, asserts CCTV, were defined by the Commission in the *Clarification of the Cable Television Rules and Notice of Proposed Rulemaking and Inquiry*, FCC 74–384, 46 FCC 2d 175, 199 (1974) [hereinafter "*Clarification*"], to "include all broadcast signal carriage and all our required access channels including origination programming. It does not include specialized programming for which a per-program or per-channel charge is made."[4] CCTV states that this distinction was maintained by the

[3] CCTV states that its "basic tier" consists primarily of signals entitled to mandatory carriage, pursuant to the Commission's signal carriage rules, as well as some satellite-delivered programming.

[4] Following the decision of the Supreme Court in *FCC v. Midwest Video Corp.*, 440 U.S. 689 (1979), the Commission deleted, *inter alia*, its access channel requirements. *Order in Docket No. 20508*, FCC 80–608, 83 FCC 2d 147 (1980), *recon. denied*, FCC 81–229, 87 FCC 2d 40 (1981).

Commission so as not to chill the anticipated development of nascent and proposed communications services within the cable industry, such as—citing *Id.* at 200—"advertising, pay services, digital services, alarm systems, two way experiments, etc." Similarly, notes CCTV, the Commission preempted rate regulation of leased access channels, citing *Id.* at 185–186. Accordingly, CCTV argues, the Commission's preemption of local rate regulation extends to satellite-delivered (and other) auxiliary cable services such as those provided by CCTV on its "expanded tier." CCTV disagrees with PSC's opinion that the Commission's recognition that "[s]atellite transmission to cable systems has become a technical reality," *id.* at 176, indicates that the Commission did not consider such services to be new and innovative. Rather, CCTV maintains that such services "had not yet become a practical reality," and that the Commission intended to maintain regulatory flexibility vis-a-vis such services through preemption. In fact, contends CCTV, the first domestic satellite receive-only earth station authorization to a cable system was granted in 1975, in *Micro-Cable Communications Corporation d/b/a Florida Cablevision* (Fort Pierce, Florida), FCC 75–931, 54 FCC 2d 881 (1975), which furthered the Commission's objective of allowing applicants to demonstrate new economies and efficiencies in the provision of existing and new specialized services, citing *id.* at 882. CCTV argues that subsequent Commission decisions reveal the Commission's intention to limit local rate regulation to those signals whose carriage is mandated by the Commission's Rules, citing the *Notice of Proposed Rulemaking in Docket No. 20681*, FCC 75–1422, 57 FCC 2d 368, 370 (1975); the *Report and Order in Docket No. 21002*, FCC 77–530, 66 FCC 2d 380, 402 n. 21 (1977), and the *Memorandum Opinion and Order and Further Notice of Proposed Rulemaking in Docket No. 21002*, FCC 79–228, 71 FCC 2d 569, 571, 584 (1979). In addition, CCTV maintains that the Commission's rate regulation preemption authority has been upheld on judicial review, citing *Brookhaven Cable TV, Inc. v. Kelly*, 573 F.2d 765 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1979), and *New York State Commission on Cable Television v. FCC*, 669 F.2d 58 (2d Cir. 1982).

5. CCTV argues that the Commission's rate regulation preemption and exemptions have furthered "exactly the type of substantial and continuing development of new and innovative cable television services which the Commission sought to encourage . . .," noting the existence of origination programming, pay cable channels, and television "superstations." As a result of the current proliferation of these and other specialized services, CCTV states that it and other cable systems offer tiers of these specialized and auxiliary services, largely satellite-delivered and voluntarily carried by the cable systems. "[S]uch tiers of specialized programming are typically grouped together and marketed at a package rate by cable television operators based on free market decisions. . . ." (footnote

omitted). In addition to the broadcast "superstations," CCTV notes that the services on its expanded tier provide twenty-four hour sports programming (ESPN); twenty-four hour news programming (CNN, SNC); and a variety of sports, entertainment and religious programming (SPN, USA, MTV, CBN). Satellite delivery of programming to cable systems, states CCTV, led to the creation of the specialized services (as well as the increased diversity of nationally-oriented programming on the "superstations"), whose programming was created explicitly for specific audiences. CCTV notes that the Commonwealth of Massachusetts Community Antenna Television Commission (hereinafter "CATC"), in its *Competitive Standard Rulemaking Report and Order*,[5] found that the scope of federal preemption of rate regulation, liberally construed, extends to all specialty services, available either by satellite or by other means, including broadcast signals which could be offered on a separate per-program or per-channel basis. Accordingly, CCTV urges that the Commission issue a declaratory ruling confirming that its rate regulation preemption extends to any specialized or auxiliary cable services distinct from regular subscriber services, and that the services provided by CCTV on its "expanded tier" fall into the former category.

Comments in Support of CCTV Requested Ruling

6. CCTV's petition is supported by the following parties: Mr. Geller and Ms. Lampert, ART, Group W, CCC, and Time. Each of these parties contends, as the basis for their analyses, that the Commission has broadly preempted the field of rate regulation of non-basic subscriber services, rendering PSC's action *ultra vires*. Proponents generally argue that both the *CTRO*, *supra*, and the *Clarification*, *supra*, reveal the Commission's intent to preempt rate regulation of non-basic subscriber services broadly, in order to avoid chilling the development of new, innovative programming and services: "i.e., advertising, pay services, digital services, alarm services, two way experiments, etc." *Id.* at 200. Accordingly, it is clear that the Commission intended its preemption to extend beyond pay services to the specialized cable programming provided by CCTV. If indeed this programming is not specifically encompassed by the *CTRO* and *Clarification*, the proponents urge that the Commission should clarify that its preemption does extend to this programming. Mr. Geller and Ms. Lampert further argue that pay cable services have benefited from the Commission's "determination to allow the new cable services to develop fully in the marketplace, unhindered by premature and in all likelihood unnecessary economic regulation." Other proponents assert that the preemption of pay

[5] Docket No. R-4 (Mass. Community Antenna Television Comm'n, July 25, 1980).

cable rate regulation was meant to foster program diversity, which they contend would be hampered by local rate regulation.[6] These proponents note that many programming services delivered by satellites and offered in tiers would not be viable were they to be made available only for a per-channel charge, and that these services include independent television broadcast stations such as WTBS, WGN-TV and WOR-TV.[7]

Comments Opposing CCTV's Requested Ruling

7. CCTV's petition is opposed by the following parties: PSC, Dallas, MPTV, CTIC, and the Cities. Each opponent contends, essentially, that the Commission's preemption of local rate regulation does not extend specifically to tiers of programming services. PSC itself notes that it "is charged by the Nevada legislature to supervise and regulate the operation of public utilites within the State of Nevada," which includes, pursuant to Nev. Rev. Stat. §§ 704.020(1)(f) and 711.080, cable television systems. This regulatory authority over cable television services, argues PSC, has been upheld by the United States Supreme Court, citing *TV Pix, Inc. v. Taylor*, 304 F. Supp. 459 (D. Nev. 1968), *aff'd per curiam*, 396 U.S. 556 (1970). PSC notes that it does not regulate MATV systems, citing Nev. Rev. Stat. § 711.040(2)(b), nor does it regulate "cable television programming for which a per-program or per-channel charge is made," citing *Brookhaven Cable TV, Inc. v. Kelly, supra*. However, PSC maintains, as it did in *In re Proposed General Order No. 40, supra*, that it may regulate tier package offerings. PSC argues that its tier package rate regulation is intended "to protect subscribers from the noncompetitive advantages that a certificated cable television company enjoys,"[8] and that such regulation will not inhibit "the Commission's

[6] Group W and Time in particular cite their experience in marketing such services to support the general theme of the proponents that local regulation would inhibit development of these services. Group W also states that both CATC and an Ohio court have found, contrary to PSC's interpretation, that tiered services are beyond local regulatory jurisdiction.

[7] ART also notes that cable systems must pay copyright fees for the carriage of distant television broadcast signals, as does Group W, who also points to the demise of services such as CBS Cable and the Entertainment Channel, as examples of the continued risks to which program suppliers and cable operators are subjected. CCC argues that optional programming services are still evolving, and that "more than half of this country's cable systems provide 12 channels or less of service," (footnote omitted), necessitating the freedom to develop and experiment with optional services which local regulation would inhibit. CCC also asserts that a rulemaking proceeding is not necessary to resolve the issues herein, citing, *inter alia*, *SEC v. Chenery Corp.*, 332 U.S. 194 (1947).

[8] PSC notes, for example, that CCTV offers one tier of primarily local broadcast signals for $7.95 per month, and a second tier of primarily satellite-delivered programming for an additional $6.95 per month. However, asserts PSC, "virtually all of the first tier stations can be received off air in Las Vegas." Accordingly, PSC

goal of promoting new and innovative television services."[9]

8. Other opponents, in addition to supporting PSC's arguments, raise further concerns. Dallas argues that grant of CCTV's requested ruling would deprive the city of its "contractual right" to regulate the rates of local cable system operator Warner Amex's second and third tiers. Dallas also asserts that to limit local rate regulation to those services which cable systems are required to carry "remove[s] from the local franchisor the authority to regulate rates for the majority of cable programming services provided to all subscribers," contrary to the Commission's dual federal-local regulatory policy. NPTV and CTIC urge that the issues raised herein are more properly the subject for rulemaking because, as CTIC claims, the declaratory ruling sought by CCTV "would . . . drastically change the way cable television rates are regulated in thousands of jurisdictions around the country, taking significant and established authority away from state and local governments." NPTV argues that preemption of local rate regulation is no longer necessary, stating that the pay cable industry has matured, and noting that such services "yielded revenues of $575 million in 1980 and accounted for more than 25% of the total cable industry revenues." (footnote omitted). As a distributor of programming through MDS, NPTV states that it "can offer only a single channel of services," compared with cable's multiplicity of channels. Unregulated cable systems could undercut MDS and other competitors, NPTV contends, whereas local pay cable rate regulation "would ensure a competitive marketplace. . . ." CTIC asserts that preemption will lead to higher rates for satellite-delivered basic services, for which there are rarely alternative suppliers, and therefore with fewer viewers, discourage the growth of advertiser-supported programming. CTIC notes the continued introduction of advertiser-supported services, such as Spanish international Network, Black Entertainment Television, Cable Satellite Public Affairs Network, The Health Channel, and The Weather Channel, despite the prevailing view of local authority concerning their legitimate capacity for rate regulation. The Cities contend that while regulation of pay services may be justified as attempting to avoid regulation of the programmer himself, tiered services have no relation to the operator's rates. The programmer is unaffected by what the operator charges the cable viewer." The Cities characterize the testimony of the WASEC employee cited by CCTV (*see* paragraph 3, *supra*) as unreliable and groundless, and argue that cable operators will not allow their program services to be

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claims, an individual must pay CCTV at least $14.90 per month to receive new services via cable television from CCTV, which enjoys a monopoly on cable services in Las Vegas and which, absent local rate regulation, could charge any price it chooses for its service.

[9] Opponents contend that the Commission years ago recognized the technical reality of satellite transmission to cable television systems, citing the *Clarification* at 176.

lost. Citing *NARUC II, supra*, the Cities maintain that "there is no nexus between the goal of the Commission and the preemption of state and local rate regulation. . . ."

Reply Comments

9. CCTV filed its reply comments on April 6, 1983. CCTV argues that, as a whole, the comments filed in this proceeding substantially support CCTV's position. In addition, CCTV contends that CTIC's opposing comments are at odds with the position of the National League of Cities (hereinafter "NLC"), "an organization representing 1,000 cities." CCTV also asserts that NPTV "competes directly with CCTV in the Las Vegas area through *inter alia*, MATV systems, which . . . PSC 'does not regulate'" (footnotes omitted), and, accordingly, characterizes NPTV's position as an attempt to hamper CCTV in its competitive challenge to NPTV. CCTV reiterates its contention that issuance of the declaratory ruling which it requests will not expand the Commission's preemption of local rate regulation, and argues that PSC has misunderstood the scope of this preemption. Moreover, noting CCC's citation of *Docket No. 20681*, 57 FCC 2d at 370, CCTV argues that regular subscriber service encompasses only those signals whose carriage is required by the Commission's Rules (and any associated required access services, as well as installation, reconnection and similar charges). CCTV denies that tiers of services are ' 'furnished' or 'provided' to 'all' subscribers because they are not 'required to be carried' by Commission regulations. . . . instead, such tiers are 'offered' as an option to all subscribers. . .," and are plainly included in the Commission's preemption. While recognizing at the time of the *Clarification, supra*, the technical reality of satellite delivery, the Commission some two years later still viewed the practical reality of such satellite use as a future development not yet capable of precise anticipation. The mode of packaging of this satellite-delivered programming – whether in a tiered or a per-channel manner – is not relevant, CCTV asserts, else one form of optional service will be subject to local regulation, while others will not be subject to such regulation. CCTV further argues that it has been the lack of regulation which has led to "exactly the type of dramatic increase in optional specialized and auxiliary programming which the Commission intended." CCTV contends that opponents have produced "no evidence that rate regulation is required to protect viewers' interests." (footnote omitted). In view of the lack of evidence of harm to cable viewers and given the benefits already gained, pursuant to the Commission's preemption policy, CCTV urges issuance of its requested declaratory ruling.

10. NCTA filed reply comments on April 7, 1983.[10] NCTA argues

[10] *See* note 2, *supra*.

that allowing rate regulation to depend upon the manner in which services are marketed will only "hamper the development of innovative cable services." NCTA challenges the assertions of CTIC and Dallas that satellite-delivered programming services are not new and innovative, and states that "[f]inding the right way to market these new services is central to ensuring their survival in an increasingly competitive marketplace." NCTA notes that cable television faces competition from conventional broadcast stations, subscription television (STV), MDS, SMATV, videocassette recorders and videoptape players, and, potentially, direct broadcast satellites (DBS) and low power television (LPTV), and characterizes opponents' fears of cable monopoly practices as unrealistic. NCTA particularly challenges NPTV's contention that, absent local rate regulation, cable operators will price their services at predatorily low rates as an attempt to preserve NPTV from competition, and antithetical to Supreme Court antitrust doctrine. NCTA contends that "[t]he public would be best served if cable, MDS and other competitors were subject to regulatory parity," and argues that just because cable is able to provide its customers many channels of programming at a lower price (due to its inherent efficiency) than competing MDS can is no reason to penalize it with unnecessary regulation to increase its cost artificially. Therefore, NCTA urges grant of CCTV's requested declaratory ruling.

Discussion

11. The issues presented in this case are best analyzed by reducing them to two questions:

- Does the Commission's preemption extend to all channels not offered as part of the basic service package, regardless of their type (*e.g.*, nonbroadcast premium, nonbroadcast advertiser-supported, or distant broadcast signals)?
- Does the Commission's preemption of rate regulation extend only to channels or programs priced individually rather than in tiers or groups?

To answer these questions it is necessary to reexamine past Commission statements on the part played by cable television in contributing to the availability of a diverse array of programming to consumers in the overall context of a constantly - changing marketplace for video services.

12. *Preemption of nonbroadcast channels.* The Commission recognized fifteen years ago that cable television's multi-channel capacity made it uniquely capable of augmenting the public's choice of programs and types of services, without the use of valuable spectrum.[11] Referring generically to these new types of nonbroadcast programming as "program originations," the Commission noted that

[11] *Midwest Television, Inc.*, 13 FCC 478, 505–6 (1968).

the cable television industry was placing "increased emphasis on program origination, both of a local and public service nature and of the entertainment type, and on the provisions of other services to the public."[12] Consistent with its recognition of the potential value of these "originations" on serving the unmet, specialized programming needs of the public, the Commission adopted rules requiring cable systems to provide at least one channel of local program originations. The Commission specified that the federal interest in program originations was not confined to locally-produced programming only:

> [The *Notice*] did not propose to restrict [cable television] to local originations or to bar originations of the entertainment type or to preclude [cable television] network operations on an interconnected basis. . . . While we regard augmented opportunities for community self-expression as extremely important, the Commission has also sought to promote new national and regional television networks generally and intends actively to explore this possibility for [cable television] . . . [13]

The Commission explained the need for exclusive federal jurisdiction to bring about these developments:

> Our experience in the broadcast field (both commercial as well as noncommercial), as well as comments filed in this proceeding, leads us to believe that the successful inauguration of any new network is not an easy matter, to a significant extent because of the high cost and other difficulties in producing or otherwise procuring programming in sufficient quantity and quality for network operations. . .
>
> . . . [T]he public interest would best be served for the present by encouraging [cable television] to experiment and develop its originations free from restriction as to interconnection or limitations as to types of programming, in the expectation that the end result will be significant added diversity for the public . .
>
> . . . The Commission would feel compelled to oppose on behalf of the public, any proposal which would preclude [cable television] systems . . . from interconnecting on a regional or national basis for any purpose, including the distribution of entertainment-type programming.[14]

13. The Commission took further steps to assure that these new services could respond to marketplace demands, undistorted by nonfederal rate regulation. The Commission specified that extra

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[12] *Notice of Proposed Rulemaking and Notice of Inquiry in Docket No. 18397*, 15 FCC 2d 417, 418, 421–2 (1968), footnote omitted.

[13] *First Report and Order in Docket No. 18397*, 20 FCC 2d 201, 203 (1969). The Commission further declared that ". . . [W]e do not mean to suggest that origination to a significant extent could not also include films and tapes produced by others, and [cable television] network programming." *Id.* at 214. Significantly, even at this initial stage of federal regulation the Commission noted the likelihood that "[cable television] channel capacity might be utilized as a means for local distribution of satellite communications." *Id.* at 208.

[14] *Id.* at 203, 205, 207.

charges could be levied by the system operator for nonmandatory originations: "While we believe that the subscribing public should not be required to pay extra fees in order to obtain access to local public service programming or presentations by political candidates on the [cable system's] origination channel, *we do not presently contemplate any prohibition against higher monthly fees or per-program charges for other minority-interest programming, or special charges for other extra services.*"[15] Having laid out this flexible overall plan for pricing nonbroadcast services, the Commission specifically declared that non-federal regulatory policies inconsistent with the federal objective of unregulated availability and pricing of nonbroadcast services were preempted.[16]

14. In adopting comprehensive rules for cable television in 1972, the Commission established an overall regulatory scheme of "deliberately-structured dualism," dividing regulatory responsibilities between itself and nonfederal authorities. Certain matters were reserved for exclusive federal control, others were given over to exclusive nonfederal control, and still others were deemed to be areas of shared jurisdiction wherein nonfederal authorities regulated pursuant to Commission-set standards. Notwithstanding this dualism we maintained our preemptive jurisdiction over nonmandatory origination channels. Dual jurisdiction would be confusing and impracticable, and desired experimentation might be jeopardized if nonfederal authorities were to specify more restrictive regulations than those prescribed by the Commission.[17] In 1974 the Commission, in the context of clarifying aspects of its overall regulatory program, took notice of the fact that many nonfederal authorities were proposing to regulate rates charged for nonbroadcast programming. Once again the Commission declared:

> It is premature to regulate along these lines. Such regulation might destroy any chance for this emerging communications service by stifling competition, setting incorrect rates, and establishing an atmosphere that deters experimentation, innovation, or speculation. We have pre-empted this area to avoid those pitfalls.[18]

This preemption, enunciated repeatedly by the Commission,[19] was upheld by the Court in *Brookhaven* v. *Kelly, supra.*

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[15] *Id.* at 216, emphasis added.

[16] *Id.* at 233. *Federal Preemption of CATV Regulation, 20 FCC 2d 741 (1969)* and *In re Request by Time-Life Broadcast, Inc.*, 31 FCC 2d 747 (1971), the latter stating categorically that, "This Commission ruled that local authorities are pre-empted from interfering with federally-authorized cable television origination and advertising. Accordingly, the Commission has preempted the field of pay television cable cablecasting so that local franchise terms are inoperative."

[17] *Cable Television Report and Order*, 36 FCC 2d 143, 193, 197 (1972).

[18] *Clarification of the Cable Television Rules and Notice of Proposed Rulemaking and Inquiry*, 46 FCC 2d 175, 185–6, 200 (1974).

15. *Preemption of distant signal carriage.* In addition to broadly pre-empting rates charged for nonbroadcast program service, we have pre-empted rates charged for distant broadcast signals not offered as part of the basic subscriber package. The Commission recognized in 1975 distant signals could be part of the mix of program services available by satellite to cable systems. This recognition came in the context of repealing the so-called "leapfrogging" rules, which generally required cable operators to select non-network affiliated broadcast stations for carriage on their systems pursuant to a prescribed formula. The rules were inconsistent with the public interest by frustrating subscribers' programming preferences. The Commission specifically noted that transmission of broadcast signals to cable systems nationwide via domestic satellite could soon be a "realistic possibility," but, nevertheless, found that the proliferation of "superstations" of this type was not likely to harm local broadcasting.[20]

16. At about the same time, the Commission issued a *Notice of Proposed Rulemaking* dealing with the regulation of rates for basic subscriber services.[21] The Commission once again delimited those services in which it had preempted jurisdiction over rate regulation. Having just amended its rules to permit cable system operators at their discretion to carry *any* distant independent broadcast signals to fill their signal complements,[22] the Commission defined "regular subscriber service rates" to be

> charges imposed for *receipt of broadcast signals required to be carried by our rules* . . . It does not apply to auxiliary services such as pay cable advertising, leased channels, etc. We continue to believe that it is premature for any rate regulation to be imposed on these other services. *We have pre-empted such regulation with the express intent of allowing the market place to function freely.*[23]

17. Thus, the Commission has deliberately preempted state regulation of non-basic program offerings, both non-broadcast programs and broadcast programs delivered to distant markets by satellite. While the nature of that non-basic offering was (and still is)

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[19] *See, e.g., Notice of Proposed Rulemaking in Docket No. 20681*, 57 FCC 2d 368, 370 (1975); *Report and Order in Docket No. 21002*, 66 FCC 2d 380, 402 n. 21 (1977); *Memorandum Opinion and Order and Further Notice of Proposed Rulemaking in Docket No. 21002*, 57 FCC 2d 569, 584 n. 27 (1979); *Report and Order in Docket No. 20272*, 54 FCC 2d 855, 863 (1975); *First Report and Order in Docket Nos. 19554 and 18893*, 52 FCC 2d 1, 67–8 (1975), *vacated and remanded on other grounds sub nom. Home Box Office* v. *FCC*, 567 F.2d 9 (1976), *cert. denied*, 98 S.Ct. 111.

[20] *Report and Order in Docket No. 20487*, 57 FCC 2d 625 (1975).

[21] *Notice of Proposal Rulemaking in Docket No. 20681*, 57 FCC 2d 368 (1975).

[22] At that time the Commission had in force rules limiting the numbers of distant signals cable systems were eligible to carry. These rules were eliminated by the Commission in 1979, thus permitting cable operators to carry as many distant signals as they wished. *Report and Order in Docket No. 21284*, 65 FCC 2d 9 (1979), *aff'd sub nom. Malrite* v. *FCC*, 652 F.2d. 1140 (2d Cir. 1981).

[23] *Notice of Proposed Rulemaking in Docket No. 20681, supra* at 370. (emphasis added).

developing, the preemptive intent, and the reasons for that preemption, are clear and discernible. Today, the degree of diversity in satellite delivered program services reflects the wisdom of freeing cable systems from burdensome state and local regulation in this area. So-called "premium" offerings such as HBO, Showtime, and The Movie Channel, along with narrowcast channels such as Christian Broadcasting Network, Nickelodeon, and Black Entertainment Television manifest the rich variety available to cable subscribers under a policy of nonbasic preemption.

18. Second, it is also clear that our preemptive jurisdiction logically extends to nonbasic services whether they are priced individually by channel or by program or as a group in one or more tiers of service.

19. "Tiering" of nonbasic subscriber services is a development of the late 1970's.[24] Tiering became feasible through the expansion of domestic satellite service, the expanded channel capacity on new or upgraded cable television systems, and the emergence of cable in the major metropolitan areas. The development of tiered services does not, however, connote that the market for cablecast video services is now mature, and that the premise for federal preemption has disappeared. Plainly, the market for cablecast video services is still volatile and rapidly changing in response not only to the specialized programming needs of cable subscribers but also to new competitive challengers in the overall video services market.[25] And the video field has grown since preemption was enunciated. In restating our preemption of regulation of nonbasic subscriber services in 1975 we cited as their competitive alternatives free television, motion pictures, live sports, and other entertainment events. Today the ranks of competitive alternatives have swelled to include video cassette, video disc, video games, home computers, low power television, multi-channel MDS, SMATV, and DBS, most of which enjoy great pricing flexibility.

20. These vigorous and growing competitors in the video services market pose a new challenge to nonbroadcast programming entrepreneurs and cable system operators. This challenge is not, as it formerly was, simply to find new services that subscribers would find attractive, but rather to package or combine services to maximize attractiveness to consumers in different markets and in anticipation of the penetration of those local markets by other, new services. In this sense it is fair to say that the development of different individual channels of nonbasic subscriber services represents but one phase—the first phase—in the evolution of the market for cable

[24] *Teleprompter Corporation*, 87 FCC 2d 540, 561 n.69 (1981).

[25] The demise of CBS Cable, the Entertainment Channel, and TeleFrance and the merger of Satellite News Channels into Cable News Network in the last year reflect the developmental character of cable program services.

video. The next phase—the one which has just recently begun—is packaging services, at appropriate prices, to meet consumer demand in a myriad of localities featuring different combinations of competitive video alternatives. The current situation requires that system operators and nonbroadcast programming entrepreneurs retain maximum flexibility in the marketplace to experiment with types of program offerings and methods to pay for such programs, *i.e.*, advertisers, subscriber fees, network compensation, or a combination.[26] Continued federal preemption is needed to preclude artificial and unnecessary skewing of the market that nonfederal regulation of entry and price could produce.[27]

21. To suggest, as do PSC and the others, that nonfederal rate regulation should depend upon the manner in which a particular service is marketed or delivered, contradicts the very basis of the Commission's preemption policy. Indeed, allowing preemption to depend upon such a distinction would, as CATC has recognized (*see* paragraph 5, *supra*), "create disjunctive practices in the marketplace," *Competitive Standard Rulemaking Report and Order* at para. 46. Absent a specific showing of a need for regulatory intervention—a showing which PSC and other opponents have not made—it is in the public interest for entrepreneurs and firms engaged in dynamic industries, such as video programming for cable television, to enjoy maximum flexibility in their responses to innovations and developments within the industry. *See, e.g., Teleprompter Corporation*, 87 FCC 2d at 579 (separate statement of Commissioner Fogarty). *Accord, First Report and Order in CC Docket No. 79–252*, 85 FCC 2d

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[26] While this proceeding is directed primarily to issues involving state or local rate controls, we remain concerned with other types of regulations that may impede new cable services and burden interstate communications. State controls over advertising on cable channels distributed by space satellite may both undercut the economic base for such services and render their operation on an interstate basis a practical impossibility. We have in the past stated that local franchise provisions or regulations that prohibit advertising in a manner consistent with our rules are preempted. *Federal Preemption of CATV Regulations, supra* note 16. The types of regulation promulgated by the state of Oklahoma in *Oklahoma Telecasters Ass'n* v. *Crisp*, 699 F.2d 490 (10th Cir. 1983), *petition for cert. filed sub. nom Capital Cities Cable, Inc.* v. *Crisp*, No. 82–1795, would thus undermine the goals of preemption articulated by the Commission in this and earlier cases.

[27] An unregulated marketplace facilitates the development of tiered services in several ways. For example, it may be efficient for prospective subscribers to be able to sample a bundle of services by making a single transaction. Likewise, tiering may simplify and reduce the costs of billing subscribers. If tier prices are regulated, new programming may be discouraged by the fear that regulation would prevent its marketing at a compensatory price. Programmers may be moved to avoid tiering of those channels that are offered, sacrificing the transactions and billing efficiencies, and cable operators would be restricted in the marketing tools they can use to bring new services to the attention of subscribers.

1, 5 (1980); *Further Notice of Proposed Rulemaking in CC Docket No. 79–252*, 84 FCC 2d 445, 453–454 (1980).[28] Moreover, it appears that the existing competitive marketplace is sufficiently capable of imposing controls on pricing policies for auxiliary video services. Accordingly, we see no reason today to limit the scope of our preemption of state and local rate regulation of services not regularly provided to all subscribers, and we find that *In re Proposed General Order No. 40, supra*, is contrary to our preemption policy and hence of no force or effect. *See Report and Order in Docket No. 20272, supra* n.20. *Accord, Telecable Associates, Inc.*, Mimeo No. 2885, 51 RR 2d 147, 152 (1982); *Commercial Communications, Inc.*, FCC 80–519, 81 FCC 2d 106, 118 (1980).

22. In view of the foregoing, we find that grant of the declaratory ruling requested by CCTV is in the public interest.

23. Accordingly, IT IS ORDERED, That the "Petition for Special Relief Requesting Declaratory Ruling" (CSR-2269) filed February 3, 1983, by Community Cable TV, Inc. IS GRANTED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

[28] The need for such flexibility is further buttressed by the fact that, as CCC has noted (*see* note 7, *supra*), most of the nation's cable systems are still twelve-channel systems. Broadcasting/Cablecasting Yearbook 1983 at D-1, D-3.

CATV Carriage, Mandatory Signal
Reinstatement
Review Application For

Requests for reinstatement and review of petitions for waiver of the mandatory signal carriage rules, which has been, respectively, dismissed and denied pursuant to delegated authority denied. Denial of applications furthers Commission objective of providing efficient and expeditious service to the public.
–*Com-West, Inc.*

FCC 83–522

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re:	
COM-WEST, INC. Muskogee, Oklahoma Muskogee County, Oklahoma	CSR-1863 OK0071 OK0160
D.F.M. OPERATING CO., D/B/A T.V. CABLE OF HENRYETTA Henryetta, Oklahoma	CSR-1985 OK0079
Applications for Review	

MEMORANDUM OPINION AND ORDER

(Adopted: November 8, 1983; Released: November 16, 1983)

BY THE COMMISSION: COMMISSIONER RIVERA ABSENT.

1. On May 26, 1983, Com-West, Inc. (hereinafter "Com-West"), operator of a cable television system serving Muskogee and Muskogee County, Oklahoma, filed a letter seeking reinstatement of its petition for special relief (CSR-1863), which the Chief of the Mass Media Bureau had dismissed on May 6, 1983. *In re Com-West, Inc.* (Muskogee, Oklahoma), Cable Television Actions Report No. 2743, Mimeo No. 4078 (released May 9, 1983). Subsequently, on July 5, 1983, T.V. Cable of Henryetta (hereinafter "T.V. Cable"), operator of a cable television system serving Henryetta, Oklahoma, filed an "Application for Review" of the action taken by the Chief of the Mass Media Bureau in *D.F.M. Operating Co., d/b/a T.V. Cable of Henryetta* (Henryetta, Oklahoma), Mimeo No. 4517, ___ RR 2d ___ (1983), denying T.V. Cable's petition for special relief (CSR-1985). Tulsa TV 41 (hereinafter "KGCT-TV"), licensee of Station KGCT-TV (Ind., Channel 41), Tulsa, Oklahoma, has opposed both Com-West's

and T.V. Cable's filings. Because the pleadings filed in these proceedings address similar issues and affect the same parties, we are consolidating these proceedings. *Teleprompter Corporation* (Santa Cruz County, California), FCC 82–356, 91 FCC 2d 146, 148 (1982).

2. Both Com-West and T.V. Cable had sought waivers of Section 76.57(a)(1) of the Commission's Rules, to avoid carrying the signal of KGCT-TV on their respective cable systems. Each petitioner argued: (1) that its cable system lacked the capacity to add KGCT-TV; (2) that action on the petitions be deferred pending resolution of the *Notice of Proposed Rulemaking in Docket No. 21472*, FCC 77–771, 66 FCC 2d 710 (1977); and (3) that, because KGCT-TV is a subscription television station and also broadcasts religious programming, the station should enjoy lesser carriage rights on cable systems.[1] In addition, in subsequent pleadings, both Com-West and T.V. Cable stated that they had activated, or shortly would activated, mid-band channels on which additional signals could be carried by means of converters. Com-West, in fact, stated that it leases its converters to subscribers for $2.00, and that it is willing to carry KGCT-TV on the system's expanded tier. In view of Com-West's offer and announced system expansion, the Bureau Chief dismissed Com-West's petition, noting, however, that if Com-West carries KGCT-TV in such a manner as to necessitate a converter for the signal's reception, Com-West must provide any such converters free of charge. *In re Com-West, Inc., supra.* Nothing that T.V. Cable's signal complement includes only five signals entitled to mandatory carriage, and also that the system has expanded to its mid-band, the Bureau Chief denied T.V. Cable's petition. *D.F.M. Operating Co., d/b/a T.V. Cable of Henryetta, supra.*

3. In support of Com-West's request for reinstatement of its waiver (CSR-1863), which we are treating herein procedurally as an application for review, Com-West argues that it never offered to provide converters free of charge to enable KGCT-TV to be carried on its expanded tier. To do so, contends Com-West, would cost it approximately $200,000.00. In opposition to Com-West, KGCT-TV notes that the Bureau Chief has not directed any particular mode of carriage of KGCT-TV on Com-West's system, but has merely required its carriage in a nondiscriminatory fashion. KGCT-TV argues that there is no basis to grant a waiver of the signal carriage rules to a cable system possessing available channel capacity, and urges that sanctions be imposed against Com-West.

4. T.V. Cable, in support of its "Application for Review" (CSR-1985), argues that "[t]he Commission has never before determined

[1] T.V. Cable also contended that its addition of Station KOKI-TV (Ind., Channel 23), Tulsa, Oklahoma, to the system's complement generated "substantial subscriber discontent. . . ."

the obligations of cable systems with respect to the carriage of time brokered specialized programming."[2] T.V. Cable likens such programming to that provided by low power television stations and by subscription television stations, and also to teletext, none of which programming is entitled to mandatory carriage status on cable systems. In opposition to T.V. Cable, KGCT-TV states that it is entitled to mandatory carriage rights as a full-service television station, whatever its over-the-air programming content.

5. It is undisputed that both Com-West and T.V. Cable possess the capacity to add KGCT-TV to their respective signal complements. Under our rules, KGCT-TV is entitled to carriage, and the arguments of Com-West and T.V. Cable in opposition thereto are not persuasive. It is settled that the pendency of a rulemaking proceeding does not affect the application of current rules. *E.g., Teleprompter Corporation*, 91 FCC 2d at 161; *Metromedia, Inc. (WNEW-TV)* (New York, New York), FCC 77–732, 66 FCC 2d 566, 568 (1977). The Bureau Chief did not require that Com-West carry KGCT-TV on the cable system's expanded tier. The Bureau Chief simply reminded Com-West that should Com-West carry KGCT-TV in such a manner as to necessitate a converter for the signal's reception, Com-West must provide the converters free of charge. *In re Com-West, Inc., supra*; *Clear Television Cable Corp.* (Berkley Township, New Jersey), FCC 74–427, 46 FCC 2d 744, 746 (1974). However, Com-West may, at its election, carry KGCT-TV on its basic tier, thereby avoiding any increased converter costs. Which of these alternatives is more appropriate to its system's operation is left to Com-West's choosing. T.V. Cable errs in its assumption that the content of KGCT-TV's programming affects its carriage rights. While KGCT-TV's subscription *programming* need not be carried by the cable system, KGCT-TV is a television broadcast station, and its non-subscription programming, whether or not of specialized interest, shall be carried by T.V. Cable. *See, e.g. Cable-Vision*, FCC 77–633, 66 FCC 2d 317, 320 (1977), *recon. denied*, FCC 78–7, 67 FCC 2d 556 (1978). The regulatory considerations applicable to low power television and to teletext are not identical to those affecting local television broadcast stations. *Compare, e.g., Report and Order in BC Docket No. 78–253*, FCC 82–107, 47 Fed. Reg. 21468 (1982), *recon. denied in pertinent part*, FCC 83–129, 48 Fed. Reg. 21478 (1983), *with Cable Television Report and Order*, FCC 72–108, 36 FCC 2d 143, 173 (1972).

6. In view of the foregoing, we find that grant of Com-West's and T.V. Cable's applications are not in the public interest.

7. Accordingly, IT IS ORDERED, That the request for reinstatement (CSR-1863) filed May 26, 1983, by Com-West, Inc. IS DENIED.

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[2] T.V. Cable states that KGCT-TV's non-subscription programming is obtained from TCI Television, which T.V. Cable describes as an "independent third party-broker. . . ."

8. IT IS FURTHER ORDERED, That the "Application for Review" (CSR-1985) filed July 5, 1983, by T.V. Cable of Henryetta IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

CATV Carriage, Satellite Stations
CATV Jurisdiction Over, By FCC
CATV Jurisdiction Over, By Local Municipality
CATV Jurisdiction Over, By State Authority
Declaratory Ruling

Petition for expedited Special Relief and Declaratory Ruling filed under Section 76.7 of Commission's Rules granted to an extent. Commission emphatically states its authority to preempt state and local regulation of SMATV systems that interfere with, delay, or terminate interstate and federally controlled communications services.
–*Earth Satellite Communications, Inc.*

FCC 83–526

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
EARTH SATELLITE COMMUNICATIONS, INC.	CSR-2347
Petition for Expedited Special Relief and Declaratory Ruling	

MEMORANDUM OPINION, DECLARATORY RULING AND ORDER

(Adopted: November 8, 1983; Released: November 17, 1983)

BY THE COMMISSION: COMMISSIONER RIVERA ABSENT.

1. The Commission has before it a "Petition for Expedited Special Relief and Declaratory Ruling" filed under Section 76.7 of the Commission's Rules on May 18, 1983, by Earth Satellite Communications, Inc. (ESC).[1] In its petition ESC requests that the Commission preclude the State of New Jersey from exercising

[1] Section 76.7 provides for a 30 day comment period, which was extended by motion until June 27, 1983. Commenting parties are: Direct Satellite Communications, Inc. (DirectSat); Antenna Specialists; ACS Enterprises, Inc.; Telecon Satellite Systems; Birdfinder Corporation; Satellite-TV Services, Ltd.; Eastco; Video East; Unlimited Communications; Wiresat Corporation; Telpar, Inc.; Grand Blanc Cable TV Co.; Suburban Cablevision (Suburban); State of New Jersey, Board of Public Utilities, Office of Cable Television (BPU); Satellite Data; Multi-View Television, Inc.; Orion Cable Systems, Inc.; TeleVista Communications; Satellite Television Corporation; Society for Private and Commercial Earth Stations (SPACE); Dean Scott & Associates, Inc. (Scott); Television Entertainment Network, Inc. (TEN); United Satellite Communications, Inc. (USCI); WWHT Corporation (WWHT) and Wometco Home Theatre, Inc. (WHT); National Satellite Cable Association (NSCA);

jurisdiction under its Cable Television Act over Satellite Master Antenna Television (SMATV) systems. An SMATV system normally serves residents of private multi-unit dwellings. It consists of a receive-only satellite earth station that provides premium programming signals transmitted to the receive station via satellite and a master antenna for the receipt of over-the-air television broadcast signals. These signals are combined and distributed through cable to subscribers residing in the multi-unit dwellings. ESC's filing is based upon an action taken by the New Jersey Superior Court in which the court enjoined ESC from operating its SMATV facility until it obtained a certificate of approval from the State of New Jersey.[2] The court found that ESC's SMATV system came within the definition of a cable television system under the New Jersey Cable Television Act, and that there has been no clear manifestation by the Congress or the Commission regarding the preemption or regulation of SMATV systems.[3]

2. Petitioner contends that this Commission has already preempted local and state regulation of SMATV systems providing interstate satellite signals, citing *Orth-O-Vision*, 69 FCC 2d 657 (1978), *recon. denied*, 82 FCC 2d 178 (1980), *aff'd sub nom., New York State Commission on Cable Television v. FCC* 669 F.2d 58 (2d Cir. 1982) [hereinafter cited as *Orth-O-Vision]. In order to "resolve any ambiguities" based on the Orth-O-Vision* holdings, ESC requests that we issue a declaratory ruling holding that the regulation of SMATV systems is preempted by this Commission "to insure the free flow of nationwide interstate satellite signals." ESC contends that the Commission is required, under the Supremacy or Commerce Clauses of the United States Constitution, to preempt state regulation which "unreasonably burden[s] interstate commerce," and cites our authority under the Communications Act to regulate interstate communi-

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National Cable Television Association, Inc. (NCTA); and New Jersey Cable Television Association (NJCTA).

[2] As will be discussed in paragraph 21, *infra*, the record is not clear as to precisely what petitioner would be required to do to obtain such a certificate.

[3] Section 76.5 of the Commission's Rules defines a cable television system:

> (a) Cable television system. A nonbroadcast facility consisting of a set of transmission paths and associated signal generation, reception, and control equipment, under common ownership and control, that distributes or is designed to distribute to subscribers the signals of one or more television broadcast stations, but such term shall not include (1) any such facility that serves fewer than 50 subscribers, or (2) any such facility that serves or will serve only subscribers in one or more multiple unit dwellings under common ownership, control or management.

Subsection (2) excludes SMATV systems serving one or more multiple unit dwellings under common ownership, control or management, which are the subject of this proceeding. SMATV systems which are defined as cable television systems by this Commission are not under scrutiny here. *See Cable Dallas, Inc.*, FCC 83–86, 53 RR 2d 651 (1983).

cations. ESC points out that this Commission "explicitly stated" that its authority to license receive-only earth stations was based on their "*integral link in interstate radio communication,*" citing *Establishment of Domestic Communication-Satellite Facilities by Nongovernmental Entities*, 22 FCC 2d 86, 99, n. 10 (emphasis added by ESC). ESC continues that the key issue in determining the interstate nature of communications is the "type of communications that pass through [a] facility," rather than the physical location of a facility. Petitioner concludes that any state law that prevents or hinders an SMATV system from receiving interstate signals "would clearly contravene Federal law."

3. In the following paragraphs, we first summarize the comments and then discuss the relevant case law and other factors leading to our decision to act in this area.

Comments

4. Although a large number of parties have joined in this dispute, their arguments fit into several basic categories: (1) the applicability of the *Orth-O-Vision* case to this situation; (2) the views of the parties with respect to federal preemption of state laws and action as they relate to the transmission of interstate signals; and (3) this preemption as it relates to SMATV and this Commission's policy toward cable television regulation at the state and local level. Paragraph 13 is a summary of ESC's reply comment which discusses why ESC believes the Commission's dual regulatory approach in cable should not be followed here.

5. Those filing comments in support of ESC agree with petitioner that the *Orth-O-Vision* holdings support Commission preemption of local and state regulation of SMATV systems.[4] Supporters of ESC argue that the interstate nature of the delivery system in *Orth-O-Vision* is indistinguishable from that of an SMATV system and that any barrier to the reception of such a signal by the states is an impermissible contravention of federal law. Opponents of ESC contend that the Commission's decision and the court's affirmation in *Orth-O-Vision* was narrowly drawn to preempt only those aspects of non-federal regulations which conflict and have the effect of burdening interstate commerce. Opponents contend that the purpose and practical effect of the New York State law was to curtail or eliminate MDS as a competitor in the pay television market, therefore impeding interstate commerce. In contrast, they argue that nothing in the record supports the contention that the State of

[4] In *Orth-O-Vision*, the United States Court of Appeals for the Second Circuit affirmed the Commission's preemption of an order issued by the New York State Commission on Cable Television which regulated, through a franchising requirement, those Master Antenna Television (MATV) systems delivering Multipoint Distribution System (MDS) signals.

New Jersey's certification process is intended to or has the effect of inhibiting competition or burdening SMATV operators.

6. TEN states that the Supremacy Clause of the Constitution, Article VI, Clause 2, provides the standard for federal preemption, i.e., where a state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," citing *Hines v. Davidowitz*, 312 U.S. 52 (1941). Citing *Perez v. Campbell*, 402 U.S. 637 (1970), TEN maintains that the crucial factor is the "*effect* rather than the purpose of the state law" in determining whether such an obstacle has developed (emphasis in original). TEN states that the effect of the New Jersey registration is to "inhibit the free flow of nationwide interstate satellite signals," by creating the requirement that a prospective SMATV operator must obtain state certification, which, per se, interferes with and limits "full development of [SMATV]."

7. DirectSat sees the Commission's mandate in this matter as set out in Sections 303(g) and 301 of the Communications Act, i.e., to "encourage the larger and more effective use of radio in the public interest," and to maintain federal control "over all the channels of interstate and foreign radio transmission." DirectSat states the "mere threat" that a "state may determine the circumstances and conditions under which SMATV systems may operate . . . is an impermissible intrusion" on the Commission's jurisdiction.

8. Suburban contends, however, that preemption is required only when the Commission is convinced that state and local regulation will impede the development of a new technology as in *Orth-O-Vision*. NJCTA argues that Congress, in enacting the Communications Act, did not intend to preempt state regulations in a certain area "unless an area of regulation specifically and inherently requires national uniformity," citing *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963). Without that need for uniformity, NJCTA states that otherwise valid state statutes must be upheld unless there exists ". . . such actual conflict between the two schemes of regulation that both cannot stand in the same area, [or if there is found] evidence of a congressional design to preempt the field. *Supra* at 83 *S.CT.*" NJCTA contends that such a conflict does not exist with state regulation of SMATV. NJCTA and BPU cite the Commission's *Cable Television Report and Order*, 36 FCC 2d 143 (1972) for the proposition that the states' interest in basic rates, franchise selection standards, franchise duration, subscriber complaints, and construction supervision should apply to SMATV as well as to franchised cable television systems. NJCTA and NCTA contend that if petitioner's arguments for preemption of SMATV are valid, then the same standard of preemption must apply to a franchised cable television operation. They argue that state and local regulation of the latter should then be limited to the "incidents of occupancy of the public streets and rights-of-way." They conclude that if the state

has a legitimate interest in regulating a cable television system beyond the occupancy of the public streets, that interest should also extend to SMATV, also described as private cable, and should not be preempted by this Commission.

9. NSCA contends that the free marketplace does and should continue to operate in the negotiation for SMATV services provided to multi-unit dwellings, be they cooperative, condominium, or rental units. NSCA states that marketplace competition allows SMATV to provide "better, quicker and more economical satellite television services" than would occur with state or local regulation, and describes the negotiation process between condominum or cooperative associations and the SMATV operator as one where the associations have more bargaining power to "regulate" prices and services than if they were served by a franchised cable television company. In the case of rental properties, NSCA contends that a landlord, frequently in consultation with tenants groups, provides SMATV service as an amenity "to attract and retain tenants" and therefore must negotiate for services and rates as do the above associations. Citing *Brookhaven Cable TV Inc. v. Kelly*, 428 F. Supp. 1216 (N.D. N.Y. 1977), *aff'd*, 573 F.2d 765 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1978), NSCA argues that SMATV subscribers also have the ability to negotiate for certain services (pay cable) and rates that cannot be regulated by state and local authority.

10. Suburban argues, in opposition, that subscribers will not be afforded the necessary consumer protections by the operation of a free marketplace. Suburban claims that NSCA has instructed its members to negotiate for exclusive contracts with landlords so that franchised cable television operators are precluded from servicing a building or complex. Consequently, Suburban states that SMATV operators will be free to set arbitrarily high prices for their services if the Commission preempts local jurisdiction. BPU states that without local regulation, residents of multi-unit dwellings served by SMATV will have no authority to "insure . . . reasonable rates for basic service, resolve service complaints and determine the qualifications of the system operators."

11. Opponents of ESC point out that SMATV is extremely similar to a franchised cable television system in the services it provides to the subscriber. They argue that the Commission recognized that in addition to cable's use of the public streets and ways, certain matters involving a franchised cable system are "appropriate for local determination," and that these matters, discussed in paragraph eight, *supra*, are equally applicable to SMATV systems. Consequently, they argue that local jurisdictions should be allowed to regulate SMATV systems. Supporters of ESC argue that the critical difference between the two technologies is cable television's use of the public streets and rights of way. Because SMATV operates on private property and does not use such public facilities, Scott

argues that the "construction and operation of SMATV systems do not necessitate the regulatory interference of a state or local body."

12. In addition to arguments raised by other parties, the New York State Commission on Cable Television (NYSCCT) argues that SMATV is not a new technology that needs this Commission's protection in order to proliferate. Rather, it maintains that SMATV is a new marketing scheme for the already existing communication technology of cable television. NYSCCT supplies us with a projected economic analysis that predicts dire consequences for the New York City franchises, as well as other urban areas, if we preempt state and local regulation of SMATV. NYSCCT states that SMATV operators can agree to give owners of multi-unit dwellings a percentage of their profits, as opposed to franchised cable operators, who are prohibited by New York state law from doing so. Based in part on this incentive, NYSCCT predicts that the revenue shortfalls to franchised cable, caused by the number of buildings that install SMATV operations, will hinder or prevent the financing, construction, completion and servicing by cable operators of franchised urban areas. Consequently, NYSCCT argues that preemption will be contrary to this Commission's articulated goal of a nationwide broadband communications network. Finally, NYSCCT argues that all interested parties "who did not know or have reason to know" of this proceeding should be given the opportunity to participate, and would have that opportunity in the context of a rulemaking proceeding rather than by means of a declaratory ruling.[5]

13. In its Reply Comments, petitioner emphasizes that the Commission's decision to establish a dual jurisdiction over cable television systems was based on a "policy choice" rather than a "legal requirement," and that in doing so, the Commission did not relinquish "its Congressional mandate to maintain control over the provision of interstate communications services," citing 47 U.S.C. §§151, 301. ESC contends that our decision was based on franchised cable's use of the public arteries, and concludes that the states do not possess the requisite nexus for asserting jurisdiction over SMATV. ESC contends that as a policy matter, the Commission should allow

[5] On September 26, 1983, NYSCCT filed a motion to allow the late filing of comments in this matter. That motion was opposed by ESC, and Satellite Television of New York Associates (STNYA) and Riverbay Corporation, two new parties to this proceeding. Notice of this matter was given by public notice on May 25, 1983, and again on June 7, 1983 when this Commission granted an extension of time in which to file comments to and including June 27, 1983. We do not agree with NYSCCT's argument that it is entitled to direct service of ESC's petition under Section 76.7(b) of the Commission's rules, since it was not a party to the specific controversy which brought ESC to this Commission. In any event, the NYSCCT had actual knowledge of this proceeding long before it filed its late pleading. However, due to the importance of this issue, we believe that the public interest dictates that the Commission consider NYSCCT's comments on an informal basis.

the free marketplace, rather than local regulation, to dictate the development of SMATV as an alternative to traditional cable.

Discussion

14. First, we turn to an analysis of the doctrine of federal preemption and attempt to resolve the threshold issue of whether this Commission has the authority to preempt state or local regulation of SMATV. The Supreme Court recently articulated the test for federal preemption in *Fidelity Federal Savings and Loan Association v. De la Cuesta*, 102 S. Ct. 3014 (1982). *Accord Pacific Gas and Electric Company v. State Energy Resource Conservation and Development Commission*, 51 LW 4449 (decided April 20, 1983). Federal agencies may decide to preempt state action in areas over which their authority extends, so long as preemption is not undertaken in an arbitrary or capricious manner. Reviewing courts must look to Congressional (or agency) intent in deciding whether state or local law has been preempted. It is well-established that, within Constitutional limits, state statutes may be expressly preempted. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977). Absent explicit preemptive language, a court may infer Congress' or an agency's intent to supersede state law because "(t)he scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," because "the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject," or because "the object sought to be obtained by federal law and the character of obligations imposed by it may reveal the same purpose." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Even when Congress (or any agency) has not completely displaced state regulation in a specific area, state law may be nullified to the extent that it actually conflicts with federal law. Such a conflict arises when "compliance with both federal and state regulations is a physical impossibility," *Florida Lime and Avocado Growers, Inc. v. Paul*, *supra*, at 142–143, or when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Hines v. Davidowitz*, *supra*, at 67.

15. We believe that in applying the above test for preemption, the Commission's authority to preempt state or local regulation of the matter here in issue—premium and broadcast signals delivered by satellite and received in multiple unit dwellings by means of SMATV systems—is clear. The court of appeals discussion in *Orth-O-Vision*, *supra*, at 64–65, regarding the Commission's authority to preempt is instructive:

> In 1934 Congress enacted the Communications Act (the "Act") and created the FCC for the purpose of regulating "communication by wire and radio so as to make available . . . to all the people of the United States a rapid, efficient,

> Nationwide, and world-wide wire and radio communication service. . . ." 47 U.S.C. § 151. Under 47 U.S.C. § 152(a), Congress directed the FCC to regulate all interstate and foreign communication by wire or radio.[11] *See United States v. Southwestern Cable Co.*, 392 U.S. [157] at 172–73, 88 S.Ct. at 2002–03 (1968). Moreover, the FCC is empowered to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). Congress gave the FCC broad authority, so as to "maintain, through appropriate administrative control, [the federal government's] grip on the dynamic aspects of radio transmission." *FCC v. Midwest Video Corp.*, 440 U.S. [689] at 696, 99 S.Ct. [1435] at 1441 [1979], *quoting, FCC v. Pottsville Broadcasting Co.*, 309 U.S. 134, 138, 60 S.Ct. 437, 439, 84 L.Ed. 656 (1940). . . . Title III of the Act, 47 U.S.C. § 301 et seq., governs the FCC's authority over radio communications. Congress has instructed the FCC to "encourage the larger and more effective use of radio in the public interest." 47 U.S.C. § 303(g), *see National Broadcasting Co. v. United States*, 319 U.S. 190, 219, 63 S.Ct. 997, 1010, 87 L.Ed. 1344 (1934), and to maintain federal control "over all the channels of interstate and foreign radio transmission." 47 U.S.C. § 301. To carry out its mandate, Congress empowered the FCC to "[m]ake such rules and regulations and prescribe such restrictions and conditions, not inconsistent with law, as may be necessary to carry out the provisions of this chapter. . ." 47 U.S.C. § 303(r).

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[11]The statutory definitions of "communication by wire" and "communication by radio" include *"all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission[s]."* 47 U.S.C. § 153(a)(b). (emphasis added).

16. As the following paragraphs indicate, the unfettered development of interstate transmission of satellite signals, obviously dependent upon facilities for their reception, is a federal concern of increasing significance to the public at large. This goal has its roots in the Communications Act of 1934, wherein Congress granted this Commission the authority to establish a pervasive system of regulation in various communications services. Section 303 of the Act gives this Commission such numerous powers so that no doubt exists as to the extent of this regulatory scheme. The need for these comprehensive powers stemmed, according to Judge [now Chief Justice] Burger, from "the practical difficulties inhering in state-by-state regulation of parts of an organic whole . . . fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communications." *General Telephone Co. of California v. FCC*, 413 F.2d 390, 398, 401 (D.C. Cir. 1968). Our discussion in the *Report and Order, Duplicative and Excessive Over-Regulation of CATV, Docket No. 20272*, 54 FCC 2d 855, 861–2 (1975), focused on traditional cable television, but also spoke in broader terms of the Commission's preemptive jurisdiction over a new communications medium:

> The Court has made it very clear that the authority of this Commission regarding "unified control" of the regulatory aspects of a new communications medium such as cable is very broad. In *National Broadcasting Co. v. United States*, [*supra*], the Court recognized that Congress had enacted legislation (the

> Communications Act of 1934, as amended) in a field that was "both new and dynamic" and that the grant of authority was of "not niggardly but expansive powers." . . . [w]e view the Federal Communications Act as the kind of legislation where Congress has delegated to the executive agency not only the power to regulate in a certain broad area of national interest but the power of supression as well. The dynamic, rapidly changing technology of radio and television broadcasting is ill-suited to specific Congressional guidelines to regulatory authority. The need for the greatest flexibility commands the desirability of vesting in the Commission the power of Congress to preempt or not to preempt areas of control which might otherwise be invaded by the states. Thus, whether preemption has in fact occurred . . . under the Supremacy Clause of the Constitution, depends on whether the Federal Communications Commission has, in fact, regulated in [an] area and not upon whether it has the power to do so.

17. Although the Commission previously has not addressed the question of preempting SMATV, *per se*, our precedent over the constituent elements of SMATV systems clearly indicates that we have, in fact, intended to preempt state regulation insofar as it frustrates the reception of satellite-transmitted signals. The program signals transmitted and the communications satellites that provide these signals to the receive station of an SMATV system are inherently interstate in nature and subject to federal regulation and preemption. *Domestic Communications Satellite Facilities*, 22 FCC 2d 86, 129 (1970). The reception facilities that are associated with the satellite systems initially were subject to Commission licensing. In 1979, the requirement for a federal authorization to construct and operate a receive station was made optional. *In re Regulation of Domestic Receive-Only Satellite Earth Stations*, 74 FCC 2d 205 (1979). In doing so, the Commission was specific that the action was taken in light of the perceived public interest values associated with competitive, unregulated entry into the earth station ownership field. The Commission stated at page 703 that we sought "the least regulation consistent with our domestic satellite policies," and emphasized at page 710 that deregulation would:

> . . . do away with redundant government regulation where the marketplace itself operates in the public interest. . . . This lowers the economic and procedural barriers inhibiting unrestricted competitive entry into the satellite field. And it removes the government from one more area where the marketplace can make its own choices.

The avoidance of barriers to satellite reception (authorized by the originator) caused by state or local licensing or economic regulation of earth station receivers is a matter that will be of growing importance as the cost of the equipment used for television, data, or other communications service reception declines. The Commission has pursued open entry policies in the satellite field for the purpose of creating a more diverse and competitive telecommunications environment. The authorization of competitive facilities, including the recent authorization of direct broadcast satellite systems, *DBS*

Report and Order, 90 FCC 2d 676 (1982), and the deregulation of earth station terminals, *supra*, demonstrate the Commission's implementation of these policies. The interposition of prior approval requirements at the state or local level contradicts our efforts to create a more rapid and efficient interstate telecommunications marketplace. Although preemption was not specifically discussed in our satellite authorization proceedings or in our deregulation of earth stations, we believe it is clear that local prior approval requirements are inconsistent with national policies in these areas. In more general terms, "receiving sets" have been held to be "absolutely essential instrumentalities" of radio broadcasting. *Station WBT v. Poulnot*, 46 F.2d 671, 675. Although a collective receiver is here involved rather than a number of individual receivers, the thrust of the stated constraints on the exercise of state regulatory power would not appear to be altered.

18. In addition, pay television service itself, the primary programming source of an SMATV system, has been preempted from state and local regulation.[6] *First Report and Order in Docket Nos. 19554 and 18893*, 52 FCC 2d 1 (1975); *Brookhaven Cable TV Inc. v. Kelley, supra*. Although *Brookhaven* primarily addresses pay cable rates, it clearly supports this preemption. In *Brookhaven*, the district court stated at page 1223:

> The FCC has determined that rates for pay cable TV should be set by marketplace forces and not regulated by state or local authorities. The rationale behind this decision is simply that rate regulation can be expected to chill development of the new medium, whereas a free market environment should enable it to grow. Since the FCC has also determined that pay cable TV will increase programming diversity it follows that efforts to nurture and protect this infant medium will, likewise, result in an increase in programming variety. This same rationale supported an earlier decision of the FCC to preclude rate regulation of another infant medium, subscription television (STV). (footnote omitted).

19. We believe that state or local government entry regulation of SMATV will "chill development" of this service or impede its growth. We therefore conclude that our preemption today will ensure continued development and increased programming diversity to viewers of SMATV.

20. We do not agree with NYSCCT that SMATV's reliance on technology similar to franchised cable should prevent us from ensuring its continued development. Nor are we persuaded by their hypothetical economic analysis of the effects on franchised cable television operations. This Commission is not an economic guarantor of competing communication technologies which may offer similar

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[6] We also recognize that many different types of signals, including broadcast signals, complete the satellite delivered programming complement of an SMATV system. All these signals, by their very nature, are interstate or affect interstate commerce. *Allen B. Dumont Labs, Inc. v. Carroll*, 184 F.2d 153, 154 (3rd Cir. 1950), *cert. denied*, 340 U.S. 929 (1951).

services to subscribers. Contrary to NYSCCT's assertion that preemption will stifle the development of broadband communications, we believe that this decision will encourage direct competition in a specific geographic area. From both a policy and a legal perspective, we find the arguments based on the interrelationship between SMATV operations and franchised cable television service to be virtually identical to arguments raised and rejected in the *Orth-O-Vision* proceeding. State or local government regulatory control over, or interference with, a federally licensed or authorized interstate communications service, intentionally or incidentally resulting in the supression of that service in order to advance a service favored by the state, is neither consistent with the Commission's goal of developing a nationwide scheme of telecommunications nor with the Supremacy Clause of the Constitution. In addition, it would appear that in states such as New York, where franchised cable is provided access to multi-unit dwellings by state regulatory fiat, these services may co-exist, or at least have the opportunity to compete for subscribers. *See e.g.*, N.Y. Exec. Law § 828 (McKinney Supp. 1982).

21. However, we recognize that countervailing state interests inhere in the present situation. Therefore, consistent with our action in *Orth-O-Vision*, *supra*, this document does not intend to preclude all state regulation. For example, we do not wish to preclude a state or locality from exercising jurisdiction over certain elements of an SMATV operation that properly may fall within its authority, such as zoning or public safety and health, provided the regulation in question is not undertaken as a pretext for the actual purpose of frustrating achievement of the preeminent federal objective and so long as the nonfederal regulation is applied in a non-discriminatory manner. Local authority over such concerns must manner. Local authority over such concerns must be exercised so that a local jurisdiction in fact does not inhibit or interfere with the delivery of interstate signals through the exercise of its authority. Certain countervailing state interests may be legitimate but would interfere impermissibly with the federal interest in establishing and maintaining interstate satellite program delivery. Our ruling herein applies to those aspects of a state or local regulatory process that, while otherwise legitimate, are inextricably connected with the delivery of interstate signals and the development of receive points so that those signals may be transmitted to subscribers among the public. As this case stands today, a superior court injunction inhibits the operation of ESC's SMATV system until Petitioner obtains a certificate of approval from the State of New Jersey. Although the record before us is not clear regarding petitioner's requirements in obtaining a certificate of approval from the state, there is no indication that the process would be *pro forma*, nor that delay in the initiation of service or termination of service would not be likely to

occur. For example, strict application of the state cable law could entail a local franchise process and/or an evidentiary hearing at the state level, should any party object to the application. The consequence of regulatory intervention in the instant matter already has been a termination of satellite video service to the public. A written inquiry from petitioner requesting guidelines on how to comply with state law remains unanswered, insofar as the record before us is concerned. We believe that this very uncertainty with respect to state and local regulatory requirements could well have a chilling effect on entrepreneurs who otherwise would enter the pay television market with offerings of satellite-transmitted program signals. We hold that aspects of the state regulatory process involving certification or registration and related procedural obligations stand as an obstacle to the accomplishment and execution of the full purposes and objectives of the Commission. The potential for such state regulation to chill the development of SMATV service conflicts with our Congressional mandate, as embodied in the Communications Act, to foster the development of national communications service. Accordingly, we hold that this New Jersey certification process, as it applies to SMATV, is preempted.[7]

22. Parties opposing petitioner's request maintain that because franchised cable systems and SMATV systems offer substantially the same service to a subscriber, the Commission should establish a dual regulatory approach to SMATV similar to the scheme that currently exists for franchised cable systems. The cable television interests argue that if we preempt local regulation of SMATV, we should do the same for all facets of traditional cable, because that medium also receives interstate signals. We agree with petitioner that the Commission established this duality as a policy decision, rather than as a matter of law, based on franchised cable's use of the public streets and rights of ways and the particular local interests considered applicable to a cable operator, generally chosen to serve the community as a whole. The Commission's *Cable Television Report and Order*, 36 FCC 2d 143 (1972) discussed the subject of dual jurisdiction at page 207. We stated in that document:

> . . . local governments are inescapably involved in the process because cable makes use of streets and ways and because local authorities are able to bring a special expertness to such matters, for example, as how best to parcel large urban areas into cable districts.

In the Commission's *Report and Order in Docket No. 20272, supra*, we discussed the question of federal preemption of cable television at page 861:

[7] We recognize that in *Orth-O-Vision, supra*, the State of New York, in fact, had denied a franchise for the operation of an MATV system. In this case we find the delay already created by state action to be analagous.

> The ultimate dividing line, as we see it, rests on the distinction between reasonable regulations regarding use of the streets and rights-of-way and the regulation of the operational aspects of cable communications. The former is clearly within the jurisdiction of the states and their political subdivisions. The latter, to the degree exercised, is within the jurisdiction of this Commission. This is so because of the interstate nature of the medium as enunciated by the Supreme Court. (footnote omitted)

See Orth-O-Vision, supra, 669 F.2d at 66, n. 16.

23. It is clear from the foregoing that the Commission possesses the authority to preempt state and local regulation of SMATV systems, and that, in fact, we have either regulated and/or preempted the elements constituting such a system.[8] In order to clear up any lingering doubt we do today, by this document, state our authority to and hereby do preempt state and local regulation of SMATV systems that have the effect of interfering with, delaying, or terminating interstate and federally controlled communications services.

25. Accordingly, IT IS ORDERED, That the relief requested under Section 76.7 of the Commission's Rules, filed on May 18, 1983, by Earth Satellite Communications, Inc., IS GRANTED, to the extent indicated above.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

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[8] Because of our previous declarations regarding the elements of SMATV, we believe that this order is a clarification and consolidation of precedent and need not be treated as a rulemaking or other expanded proceeding. We also believe that parties interested in this matter have had adequate notice to comment. *See* footnotes 1 and 5, *supra*.

Political Broadcast
Political Broadcast, Candidate Debates
Political Broadcast, Exempt Documentary
Political Broadcast, Exempt News Event

Report and Order adopted granting in part petitions for broadened interpretation of subsections 315(a)(3) and 315(a)(4) of the Communications Act regarding exemption of news documentaries and political debates.
–Henry Geller
BC Docket No. 82–564

FCC 83–529

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Petitions of HENRY GELLER and National Association of Broadcasters and the Radio-Television News Directors Association to change Commission interpretation of Subsections 315(a)(3) and (4) of the Communications Act	BC Docket No. 82–564

REPORT AND ORDER

(Adopted: November 8, 1983; Released: November 16, 1983)

BY THE COMMISSION: COMMISSIONER QUELLO ISSUING A SEPARATE STATEMENT; COMMISSIONER RIVERA ABSENT.

1. On August 18, 1982, the Commission issued a Notice of Inquiry concerning its interpretation of subsection 315(a) of the Communications Act of 1934, as amended, 47 U.S.C. § 315(a).[1] That provision provides as follows:

> If any licensee shall permit any person who is a legally qualified candidate for any public office to use a broadcasting station, he shall afford equal opportunities to all other such candidates for that office in the use of such broadcasting station: Provided, That such licensee shall have no power of censorship over the material broadcast under the provisions of this section. No obligation is imposed under this subsection upon any licensee to allow the use of its station by any such candidate. Appearance by a legally qualified candidate on any-
> (1) bona fide newscast,

[1] 47 Fed. Reg. 41421, released September 20, 1982. Comments were due October 15, 1982. Reply comments were due November 15, 1982.

(2) bona fide news interview,
(3) bona fide news documentary
(if the appearance of the candidate is incidental to the presentation of the subject or subjects covered by the news documentary), or
(4) on-the-spot coverage of bona fide news events (including but not limited to political conventions and activities incidental thereto), shall not be deemed to be use of a broadcasting station within the meaning of this subsection.

2. The Commission's Notice of Inquiry was issued in response to petitions by Mr. Henry Geller and the National Association of Broadcasters and the Radio-Television News Directors Association (NAB-RTNDA) requesting that the Commission establish through rule making or declaratory ruling the following:

1) that broadcast of a debate between legally qualified candidates may be within the § 315(a)(4) exemption even if the debate is sponsored by the broadcaster;

2) that the § 315(a)(4) exemption includes delayed broadcasts or rebroadcasts of bona fide news events, such as debates, even if aired later than one day after the event; and

3) that the § 315(a)(3) exemption includes a bona fide news documentary even if a candidate's appearance in it is significant, if such appearance is incidental to the presentation of the subject or subjects of the documentary.

3. As explained below, we have decided that the requested interpretations of subsection 315(a)(4) fully comport with the terms and legislative history of this provision. We also believe these interpretations will remove unjustified hindrances to achieving the purpose of the provision; namely, to maximize broadcast coverage of political events by permitting increased broadcaster discretion in providing such coverage. However, we have decided not to adopt the requested interpretation of § 315(a)(3), but to continue instead our present practice of examining, case-by-case, any documentary whose eligibility for the exemption is challenged.

Comments of Parties[2]

4. The Notice of Inquiry requested, *inter alia*, comments on whether exemption of broadcaster-sponsored debates would be consistent with the pertinent legislative history, statutory language,

[2] The following parties submitted comments in this proceeding: CBS; Henry Geller and Donna Lampert; American Broadcasting Companies, Inc. (ABC); RTNDA, Gannett Co., Inc., and The Society of Professional Journalists, Sigma Delta Chi (RTNDA); NAB; Public Broadcasting Service (PBS); Griffin Television, Inc., Hubbard Broadcasting, Inc., King Broadcasting Company, Leake TV, Inc., and Puerto Rico Broadcasting, Inc. (Griffin); McKenna, Wilkinson & Kittner (MW&K); National Public Radio (NPR); Cosmos Broadcasting Corporation, Cox Communications, Inc., Multimedia, Inc., and WHP, Inc. (Cosmos); NBC, Inc.; Federal Election Commission (FEC); League of Women Voters Education Fund; League of Women Voters of California; Office of Communication of the United Church of Christ (UCC); Stuart N. Brotman, Esq; and John B. Anderson. Reply comments were submitted by ABC; CBS; NBC; NAB; Joel Scott Reish; League of Women Voters of California; RTNDA and Geller and Lampert.

and case law. Most of the parties appear to be in agreement that neither the legislative history nor the statutory language squarely addresses the issue. Henry Geller and Donna Lampert state that the legislative history and the statute "[afford] the Commission considerable leeway as to the issue," citing *Aspen Institute Program on Communications, etc.*, 60 FCC 2d 697 (1975). CBS cites *Aspen* for the proposition that the Commission has "considerable discretion" to interpret and apply the news exemptions. Many of the supporting parties point out that the legislative history and the statute do not differentiate between debates sponsored by broadcasters and nonbroadcasters. Most of the comments in favor of petitioners' proposal also cite the court of appeals' statement in *Chisholm v. FCC*, 538 F.2d 349, 360 (D.C. Cir. 1976), that the legislative history reflects:

> the broad intent of Congress to maximize broadcast coverage of political events and to increase broadcaster discretion, as well as Congress' expressed willingness to take some risks with the equal time philosophy in order to achieve these goals and to grant the Commission some leeway in interpreting the exemptions. . . .

In contrast, the UCC states that the legislative history can be construed to exclude broadcaster-sponsored debates from the type of programming Congress intended to exempt from equal opportunities obligations. John B. Anderson interprets the legislative history to "reflect Congress' intent to limit broadcasters' power to discriminate among candidates and to favor some candidates at the expense of others" and believes it precludes the interpretations requested by Mr. Geller and NAB-RTNDA.

5. Several of the commenting parties discussed the definition of the terms "bona fide" and "on-the-spot coverage" included in the statutory language. ABC states that "the statute is only concerned with whether the broadcaster's judgment that the event is newsworthy is reasonable and made in good faith (i.e., 'bona fide')," concluding that the statutory phrase "bona fide" means no more than the exercise of bona fide news judgment. Cosmos suggests that the standard for interpreting "bona fide" for a broadcaster-sponsored debate should be based solely on "news judgment as opposed to furthering a particular candidacy." NBC points out that nothing in the statutory language "mandates exemption only for debates arranged by non-broadcasters." Henry Geller and Donna Lampert state that the term "on-the-spot coverage of a bona fide news event" can be easily interpreted to cover broadcaster-sponsored debates. John B. Anderson, however, states that the term "bona fide" must be read to mean an event that is not "staged" or "created" by the broadcaster. He believes that a "news event" must be "covered" by the broadcaster rather than "created."

6. Many of the comments supporting the petitions contend that a debate between candidates is no less newsworthy because the

sponsoring entity happens to be a broadcaster. MW&K states that both the *Aspen* and *Chisholm* rulings are based on a "policy recognition" that the public interest is served by allowing broadcasters "to contribute to a more informed electorate," citing *Aspen* at page 706. Several of the comments stress that state or local contests may not find third parties to sponsor debates, leaving the public less informed than if broadcasters were allowed to arrange the debate without equal opportunities considerations.

7. In its comments, the FEC addressed only the issue of broadcaster sponsorship of debates. It suggested that if this Commission were to alter its interpretation of § 315(a)(4) to permit exemption of broadcaster sponsored debates from equal opportunities requirements, the FEC might be required to reconsider its regulations on corporate-broadcaster-funding of candidate debates (11 CFR Parts 100, 110, and 114). It said that in creating in these regulations an exemption to permit certain nonprofit and news media organizations to stage nonpartisan federal candidate debates the FEC had relied heavily on its belief that sufficient safeguards as to the nonpartisanship of debates staged by broadcasters was set forth in the Communications Act and existing regulations and interpretations of the FCC, including the equal time obligation imposed on broadcasters who stage and sponsor candidate debates. Several reply commenters argued, in essence, that the FEC's comments are legally questionable and, in any event, irrelevant to this Commission's proper interpretation of the § 315(a) exemptions.

8. A majority of the comments supporting the petitions urge the Commission to abandon the guidelines enunciated in *Delaware Broadcasting Company* [3] and *John F. Donato* [4] and to give broadcasters the discretion to use their good faith news judgment to determine when to broadcast or rebroadcast, in its entirety, a debate between candidates. Several of the comments contend that our current interpretation is mandated neither by the legislative history nor the statutory language of Section 315. A few of the comments assert that a debate will not lose its newsworthiness after a 24-hour period, and that the passage of time will not create a climate for broadcaster discrimination. NPR and PBS point out that the current standard does not allow stations the flexibility to schedule such events based on the needs of the audience, particularly those noncommercial stations that provide a service "uniquely attuned to the many audiences they serve." UCC points out that in addition to maximizing the potential audience for delayed debate broadcasts, such debates rebroadcast during the closing days of a campaign may "enable the audience to determine the extent to which the candi-

[3] 60 FCC 2d 1030 (1976).
[4] 66 FCC 2d 599 (1977)

dates had changed their positions." However, John B. Anderson states that the current standard stated in *Delaware* and *Donato* "squarely rejected the very arguments" petitioners urge here, and states that petitioners' interpretations of "on-the-spot" is inconsistent with congressional intent.

9. Our Notice of Inquiry requested comments regarding Mr. Geller's proposal that candidate appearances in exempt documentaries may be significant, while remaining incidental to the topic addressed in the documentary, with the nature and amount of the appearance left to the good faith judgment of the licensee. Griffin suggests that "incidental" be interpreted as a candidate appearance that "cannot reasonably be judged, viewing the documentary as whole, as a significant purpose of the documentary." CBS states that a restrictive interpretation of candidate appearances infringes on broadcasters' journalistic discretion without preventing "political favoritism." CBS asserts that the legislative intent behind Section 315 was to permit news coverage of campaigns and issues without the constraints of equal opportunities obligations. CBS interprets "incidental" not as a quantitative measure, but as an appearance related but secondary to the topic addressed in the documentary. ABC and MW&K suggest that "incidental" should be interpreted as an appearance by a candidate which is not the central or predominant theme of a given program. NBC suggests that the length of a candidate appearance is "merely an indication of the broadcaster's good faith and reasonableness," and that the Commission should look to the intent of the broadcaster. However, Cosmos believes that Mr. Geller's proposal is "too abstract" and would be "impossible to define adequately and is unnecessary." John B. Anderson suggests that "significant appearances are not incidental, almost by definition." UCC states that there is "substantial risk" that adoption of the proposed interpretation would "create confusion, considerable litigation, and be inconsistent with congressional intent. . . ."

Discussion

10. Before addressing the matters raised by the commenters, it may be useful to review briefly the current status of Commission policy concerning the statutory provisions under consideration. As noted by many of the parties to this proceeding, the § 315(a) exemptions were added to the Communications Act in 1959 in reaction to the Commission's then recent *Lar Daly* decision.[5] In that ruling, the Commission held that an appearance by a candidate in a regular newscast was a "use" triggering the requirement in § 315(a) that "equal opportunities" be afforded other qualified candidates for the same office. The purpose of the exemptions added to § 315(a)

[5] *Columbia Broadcasting System (Lar Daly)*, 18 R.R. 238, recon. den., 26 FCC 715 (1959).

"was to reverse the Commission's construction [*in Lar Daly*] of the equal opportunities requirement. Congress feared that the Commission policy would deter broadcast licensees from covering political news by inspiring 'a parade of aspirants' to seek free air time following any coverage of political campaigns." *UCC v. FCC*, 590 F.2d 1062, 1067 (D.C. Cir. 1978).

11. In *Chisholm*, *supra*, the court of appeals upheld a decision of this Commission that reversed a statutory interpretation of over ten years duration and held that debates between qualified political candidates could be bona fide news events exempt from the equal opportunities requirement of § 315(a). However, the Commission required that to qualify for the exemption the debates be initiated by nonbroadcast entities. In *UCC*, *supra*, the court also upheld a Commission decision that a broadcast otherwise exempt under § 315(a)(4) was not denied exemption as "on-the-spot coverage" simply because it was broadcast on a delayed basis. Nevertheless, in *John F. Donato*, *supra*, we determined that a debate rebroadcast 2 1/2 days after the event was not exempt, absent unusual circumstances.

12. We do not believe that the Commission's rulings described above represent the outer limits of permissible interpretations of the Section 315(a) exemptions, as some of the parties to this proceeding seem to suggest. Rather, after a careful re-examination of these matters, we have concluded that the less restrictive interpretations of § 315(a)(4) requested by Mr. Geller and NAB-RTNDA more accurately reflect both the letter and purpose of the 1959 amendments.

A. *Discretionary vs. Mandatory*

13. It is abundantly clear from the legislative history and the express delegating provision of § 315(d) that the Commission has broad discretion in interpreting and implementing the § 315 exemptions. Congress recognized that the task of defining the delineated exemptions would be difficult and thus refrained from specifying their scope. Instead, it conferred this responsibility upon the agency with expertise in broadcasting matters and familiarity with programming.[6] Further, the entire thrust of the 1959 amendments and their legislative history evidence a congressional intent to enhance the exercise of broadcasters' good faith news judgments to enable more extensive coverage of political issues[7], balancing the important goals of equal treatment of candidates and the public's need to be apprised of newsworthy issues. Accordingly, as the court

[6] S. Rep. No. 562, 86th Cong., 1st Sess. at 12; 105 Cong. Rec. 14439 (July 28, 1959) (Pastore); *id.* at 14455 (Pastore); *id.* at 16227 (August 18, 1959) (Celler); *id.* at 17778 (Harris).

[7] 105 Cong. Rec. 14439 (Pastore); *id.* at 16236 (Flynt); *id.* at 16240 (Cunningham); *id* at 17832 (Pastore).

in *Chisholm* observed, although the legislative history is rather vague, *id.* at 357, it is clear that Congress intended to give broadcasters great discretion in their news programming decisions, *id.* at 351, 358–60, and to give the Commission great leeway in its interpretation and application of the exemptions, *id.* at 351, 357. Specifically, the court stated:

> In creating a broad exemption to the equal time requirements in order to facilitate broadcast coverage of political news, Congress knowingly faced risks of political favoritism by broadcasters, and opted in favor of broader coverage and increased broadcaster discretion. Rather than enumerate specific exempt and non-exempt 'uses', Congress opted in favor of legislative generality, preferring to assign that task to the Commission.

Id. at 366. As will be discussed in greater detail below, we believe the Commission's current interpretations of § 315(a)(3) and (4) come within the scope of its discretionary authority and are not congressionally mandated. Moreover, as the court in *Chisolm* pointed out, subsequent congressional acquiescence does not necessarily indicate that the Commission's interpretations of the § 315 exemptions are the "only, or the best" interpretations, but is merely consistent with Congress' intent to delegate to the Commission the responsibility of applying the exemptions to specific formats. *Id.* at 362. In exercising that authority, we now conclude that our previous interpretations do not comport with the overriding objective of the exemptions to encourage broadcast coverage of political issues.

B. *Station-Sponsored Debates*

14. For purposes of § 315(a)(4), the Commission currently requires a broadcast debate, among other things, to be sponsored and controlled by a third party not associated with the licensee. This restriction is based upon a belief that to exempt broadcaster-controlled debates would create too great a risk that a broadcaster might be able to favor certain candidates in contravention of the spirit and purpose of the § 315 equal opportunities provision. Thus, to qualify for the exemption, the "licensee must decide independently to cover an existing event" and must assume the role of an "observer and reporter, who is in no way responsible for selection of the event's content, format and participants." *Chicago Educational Television Association*, 58 FCC 2d 922, 923 (B/C Bur. 1976). Consistent with this policy, in *Socialist Workers Campaign*, 88 FCC 2d 349, 352 (B/C Bur. 1981), the Broadcast Bureau explained that the critical factor in determining whether a debate is exempt is the "role and intent of the broadcaster" in covering the event, so that the broadcaster's control would remove the broadcasted debate from the exemption. This interpretation, however, is not persuasive in light of the legislative history of the exemptions.

15. It is true that during passage of the 1959 amendments to

Section 315, several Congressmen expressed concern about the inclusion of panel discussions and/or debates within the exemption, and in response to those concerns, a proposal to include panel discussions among the categories of exempt programming was rejected. It does not follow, however, that the non-exempt status of broadcaster-sponsored debates conforms to or is required by general congressional directive. As the court in *Chisholm* pointed out, the elimination of panel discussions and debates from exempt classification is not dispositive. Specifically, the court noted:

> The elimination of such specific formats, however, was not intended to exclude them if they could qualify under one of the general categories of news coverage in the final bill. Oren Harris, Chairman of the House Committee and the bill's floor manager, stated:
>
> [T]he elimination of these categories was not intended to exclude any of these programs if they can be properly considered to be newscasts or on-the-spot coverage of news events. [Citation omitted].
>
> In short, in the final version of the bill, Congress opted for exemptions based on general categories relating to news coverage, rather than on specific program formats, and this of necessity left the Commission with the task of deciding which particular events could qualify within the limits of the statutory language.

Chisholm, supra, at 357, n. 17.

16. Nor does the "plain meaning" of the statutory language "on-the-spot coverage of bona fide news events" support an argument that broadcaster-sponsored debates fall outside the scope of the exemption, thereby limiting the exemption to circumstances in which the broadcaster's role is that of an observer or a reporter. As NAB points out, the term "coverage" is "neutral in terms of content and degree" and refers both to "acts of gathering and disseminating news."

17. In our view, the term "bona fide" (which is used to qualify all the § 315 exemptions) was intended to emphasize Congress' intent that the programs be of genuine news value and not be used to advance the candidacy of a particular individual.[8] There is no indication that by exempting "on-the-spot coverage of a bona fide news event" Congress intended to exclude broadcaster-sponsored debates from the exemption. As the court in *Chisholm* stated:

> [T]he four exemptions apply generally to news broadcasts and . . .. [A]ll of the exemptions, in fact, contain the requirement that the program or event be 'bona fide' news, yet the language itself provides no ready clue as to how this requirement is to be satisfied. It is unclear from the statute whether the test refers to the character of the event (i.e., its inherent newsworthiness), the nature of the candidate's appearance (i.e., whether the format is that of debate, press

[8] Conference Rep. No. 1069, 86th Cong., 1st Sess. at 4 (1959); 105 Cong. Rec. 14442 (Pastore); *id.* at 16224 (Brown); *id.* at 17828 (Pastore); *id.* at 17777 (Scott).

conference, speech, etc.), or the candidate's relation to the broadcast (i.e., whether he controls it).[9]

18. Moreover, according to the legislative history, panel discussions and debates are exempt if they come within *either* the exemption for a "bona fide news interview" program *or* "on-the-spot coverage of bona fide news events." Given the fact that licensees or networks customarily have control over interview programs, it makes little sense to contend that the presence of similar control in the coverage of an event of bona fide news value should preclude exemption. To render such an exemption contingent upon the broadcaster's control, or lack thereof, appears arbitrary at best, for the risk of favoritism is no less in a newscast or news interview program, where control and responsibility also vest in the licensee or network.

19. In sum, although Congress expressed a concern that the freedom and flexibility accorded to broadcasters in their news programming might result in favoritism amongst candidates, Congress intended to permit that risk in order to foster a more informed electorate. Congress did not intend to exclude broadcaster-sponsored debates from the Section 315 exemptions to eliminate any risk of favoritism because to do so would undermine the informing goal of the statute. In our view, the common denominator of all exempt programming is bona fide news value. Thus, a debate's exempt status is not and should not be contingent upon whether a broadcaster is the sponsoring or controlling entity—for such control generally would not affect the program's news value.[10] Furthermore, exempting broadcaster-sponsored debates should serve to increase the number of such events, which would ultimately benefit the public.

20. We note, of course, the argument of the League of Women Voters that since our *Aspen* ruling it has sponsored many debates by candidates for office at all levels of government which have been covered by broadcasters. But without in any way denigrating this valuable contribution of the League, we are persuaded by the argument of Mr. Geller and others that in many instances a broadcaster may be the ideal, and perhaps the only, entity interested in promoting a debate between candidates for a particular office,

[9] *Id.* at 356. In fact, several Congressmen expressed their beliefs that equal opportunities are triggered only when the *candidate* initiates the use. For example, Congressman Brown stated, "Where its [sic] legitimate news or coverage of a legitimate news event instigated by media and not the candidate, equal time is not appropriate." 105 Cong. Rec. 16244. *See also* 105 Cong. Rec. 14442 (Pastore).

[10] Indeed, even Judge Wright recognized in his dissenting opinion in *Chisholm*, that "it belittles this concern [of several Congressman that debates and panel discussions were rather vague categories] to conclude that the deleted program categories can be made into exempt 'news events' simply by the existence of a nonbroadcaster sponsoring organization." *Id.* at 374, n. 35.

especially at the state or local level. And where this is true, an interpretation of § 315(a)(4) which precludes or discourages such sponsorship and coverage of a debate denies to the public valuable news of precisely the sort Congress intended this exemption to make available.

21. We have also considered the argument by the League and others that to permit a broadcaster to both sponsor and broadcast a debate exempted from equal opportunities requirements would repose excessive power in the broadcaster to favor or disfavor particular candidates. However, a broadcaster-sponsored debate clearly can, as we have said, be a bona fide news event, and any such event is therefore within both the terms and purpose of the § 315(a)(4) exemption. And even assuming that permitting broadcasters to both sponsor and broadcast exempt debates involves some risk, no showing has been made, and we cannot assume, that such risk is beyond that which the *Chisholm* court acknowledged Congress knowingly accepted as the price of achieving the purpose of the 1959 amendments.[11] Moreover, we believe that requiring exempt debates to be arranged and sponsored by a person or entity other than the broadcaster does not comport with indications in the legislative history of the § 315(a) exemptions that a common characteristic of exempt programs would be control of their content, format, and production by the broadcaster.[12] Therefore, we have decided that the alternative interpretation proposed by the petitioners, which would achieve more fully the fundamental congressional purposes, should be adopted.

22. In deciding that broadcaster-sponsored debates should be entitled to the § 315(a)(4) exemption, we are aware of the FEC's concern that such a decision might require it to reconsider its regulations on corporate-broadcaster-funding of candidate debates. On this point, we believe, as did some of those who commented in reply, that the FEC's interpretation and administration of the Federal Election Campaign Act is irrelevant to our proper interpretation of § 315 of the Communications Act. In fact, the FEC did not

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[11] We do not agree with Mr. Anderson's argument that nonrepeal of § 315(a) evidences Congressional intention to avoid even remote risk of discriminatory news coverage of political campaigns and candidates by broadcasters. On the contrary, we think it clear that Congress was willing to incur substantial risk of such abuse to achieve the public benefit of fullest broadcast coverage of political news. "In establishing the category of exemptions from Section 315, the Committee was aware of the opportunity it affords a broadcaster to feature a favorite candidate. This is a risk the Committee feels is outweighed by the substantial benefits the public will receive through the full use of this dynamic medium in political campaigns." Sen. Rep. No. 562, 86th Cong., 1st Sess. (1959) p. 14.

[12] Sen. Rep. No. 562, 86th Cong., 1st Sess., p. 11; Congressional Record-House, Sept. 2, 1959, p. 17781 (remarks of Congressman Harris); Congressional Record-House, Aug. 18, 1959, p. 16246 (remarks of Congressman McGovern).

even suggest that our proposed interpretation was wrong. Consequently, although, we appreciate the FEC's submission of comments, they have not influenced our decision in this proceeding.

C. *Delayed Broadcasts*

23. On the second point at issue in this proceeding, delayed broadcast or rebroadcast of debates and other news events, we find that the present 1-day rule for inclusion within the § 315(a)(4) exemption is neither required by law, nor sound as a matter of policy.

24. As a starting point, we think it clear that the *UCC* decision, *supra*, established that *some* delay in the broadcast of a news event is permissible without excluding the broadcast from the § 315(a)(4) exemption. The court therein conceded that "on-the-spot coverage" connotes "timeliness," but noted that the statute and legislative history do not preclude delayed broadcasts of political events, *id.* at 1068, or the use of taped material, *id.* at 1066. Thus, it appears to us that the Commission's current interpretation of the term "on-the-spot" as requiring nearly contemporaneous broadcast coverage is not legally required. The legislative history is silent as to a "contemporaneous" restriction; it merely addresses the relative newsworthiness of the event as the touchstone for exemption.[13] Under this standard, the existing one-day limitation appears unduly restrictive. We believe that a broadcaster's good faith determination to delay or rebroadcast a newsworthy debate later than the day after the event to maximize audience potential may come within the exemption. Such an interpretation is clearly consistent with, and in furtherance of, one of the basic purposes of the 1959 amendment:

> [T]o enable what probably has become the most important medium of political information to give the news concerning political races to the greatest number of citizens and to make it possible to cover the political news to the fullest degree.

105 Cong. Rec. 14451 (Holland); *see also* 106 Cong. Rec. 13424 (Pastore).

We therefore disagree with the view expressed in *John F. Donato, supra*, that the usefulness of delayed broadcasts and rebroadcasts in conveying news to persons who would otherwise be denied it is irrelevant to the application of § 315(a)(4). To the contrary, enabling broadcasters to convey more news to more people is the whole purpose of that provision, and that purpose is substantially frustrated by the arbitrary and restrictive 1-day rule announced in *Delaware* and applied in *Donato*. We now believe instead that the only

[13] *See* note 8, *supra*.

reasonable rule-of-thumb on the meaning of the § 315(a)(4) exemption is that it encompasses news reports of any reasonably recent event intended in good faith by the broadcaster to inform the public and not intended to favor or disfavor any candidate.

D. *Presentation of Campaign Issues and Candidates on Documentaries*

25. On the third issue in this proceeding, whether a "significant" appearance of a candidate in a documentary denies the documentary exemption under § 315(a)(3), we note that the Commission has never established or approved any specific standard on this matter. We see no reason to do so now.

26. It is already established that documentaries may address campaign issues and still be within the Section 315(a)(3) exemption. See *Use of Broadcast Facilities by Candidates for Public Office*, 35 Fed. Reg. 13054–55, Quest. 20 (1970). Therefore, the only question presented is whether a candidate's appearance may be significant, yet remain incidental to the subject or subjects of the documentary, for purposes of the exemption. According to the Conference Report:

> [T]he appearance of a candidate on a news documentary is exempted only if such appearance is incidental to the presentation of the subject or subjects covered by the news documentary. Thus, a program which deals predominantly with a candidate would not be a news documentary exempted. . . .

Conference Report, note 8 *supra*, at 4. The only attempt to characterize or define a documentary was by way of Senator Pastore's brief explanation. He described a documentary essentially in terms of a program which delves into the background or the genesis of a news event of contemporary value to give the event a more meaningful perspective in the minds of the viewing or listening public.[14]

27. Beyond these general propositions, we do not believe it is useful to pursue at this time the question whether a "significant" appearance in a documentary might fall within the exemption. Rather, we believe it is preferable for the Commission to decide this question in a concrete, factual context, particularly since the need for clarification does not appear to be pressing, nor does it appear to present a recurrent problem. Accordingly, we are deferring any expression of opinion concerning this aspect of Mr. Geller's petition.

Conclusion

28. A reading of the legislative history and court decisions makes clear that Congress has conferred upon the Commission wide discretion in interpreting and applying the § 315 exemptions. We

[14] 105 Cong. Rec. 14441.

believe the Commission should exercise that discretion by broadening its interpretation of § 315(a)(4), thereby affording broadcasters greater flexibility in their news programming determinations and promoting political education of viewers and listeners. In our view, this approach to § 315(a)(4), although it represents a departure from previous Commission rulings, is more consistent with the purposes of the 1959 Amendments.

29. Accordingly, it is ordered that the petitions filed by Mr. Geller and NAB/RTNDA on April 16 and April 19, 1982, respectively, are granted to the extent indicated herein and are otherwise denied. It is further ordered that the proceeding in BC Docket No. 82–564 IS TERMINATED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

SEPARATE STATEMENT OF FCC COMMISSIONER JAMES H. QUELLO

In re: Petitions of Henry Geller and the National Association of Broadcasters and Radio-Television News Directors Association to Change Commission Interpretation of Subsections 315(a)(3) and (4) of the Communications Act.

During my tenure as a broadcaster in Detroit, I had numerous opportunities to work with the local and state chapters of the League of Women Voters. From this experience, I gained the highest regard for that organization's impartiality, its competence, and its ability to be of great value to a broadcast station manager. To the best of my knowledge, that organization, and others, have done an excellent job in organizing candidate debates which broadcasters cover as *bona fide* news events.

Given that the existing system appears to be successfully providing valuable information to the public, I brought some reluctance to this proposal for change. Upon reflection, however, I must endorse this decision fully because I see no sound basis to continue these restrictions on broadcasters' First Amendment rights and their related ability to ensure that the public is informed.

The existence of these restrictions casts a shadow on the journalistic integrity of the electronic media, and while I can foresee a continuing role for the League of Women Voters and similar organizations in organizing political debates, such participation should come about because of the value of these organizations' contributions, not because of unnecessarily intrusive government fiat.

Common Carrier
Rules, Waiver of

Petition for waiver of Section 31.232(b) of rules granted subject to state approval of amortization period for inside wiring. Action facilitates maintenance of an unregulated, competitive marketplace.
—*Illinois Bell Teleph. Co.*

FCC 83–585

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of

Petition for Waiver of Section 31.232(b) of the Commission's Rules so that Illinois Bell can amortize station connection - inside wiring over six years.

MEMORANDUM OPINION AND ORDER

(Adopted: December 14, 1983; Released: December 21, 1983)

BY THE COMMISSION: COMMISSIONER PATRICK NOT PARTICIPATING.

1. This Order is in response to a Petition for Waiver filed by Illinois Bell Telephone Company (Illinois Bell) pursuant to Section 1.3 of the Commission's Rules and Regulations. The Petition seeks to change the amortization period established in *Expensing of Inside Wiring*, First Report and Order in Docket 79–105, 85 FCC 2d 818 (1981), for Illinois Bell's station connection-inside wiring. We have decided to grant Illinois Bell's request, subject to state commission approval.

2. In *Expensing of Inside Wiring, supra*, this Commission ordered all subject carriers to separate their station connection investment, all of which was recorded in account 232, "Station connections," into at least two subclasses, "Station connections-inside wiring" and "Station connections-other."[1] This was a continuation of efforts which had begun with *Charges for Interstate Services*, Docket No. 19129 (Phase II), 64 FCC 2d 1 (1977), reconsideration, 67 FCC 2d 1429 (1978), to place the burden of costs associated with station connec-

[1] The Report and Order in *Station Connections-Other*, Docket No. 82–679, 48 Fed. Reg. 49843, released October 26, 1983, removed the "station connections-other" subclass from account 232 and retitled the account "Station connections inside wiring." This Order hereinafter refers to account 232, "Station connections-inside wiring."

tions on the ratepayer who causes the costs to be incurred. It defined "Station connections-inside wiring" as that segment of the wiring from the customer's side of the protector to the customer premises equipment. It was decided that inside wiring cost incurred in the future should be charged directly to expense when incurred[2] and that the embedded investment for inside wiring should be amortized to expense over 10 years.

3. On June 17, 1983, Illinois Bell filed its Petition for Waiver to amortize the investment in the "Station connections-inside wiring" subclass over a six-year period ending December 31, 1986, rather than the currently mandated ten year period. Additionally, Illinois Bell requested that this waiver be effective upon the Illinois Commerce Commission's approval of rates based upon company revenue requirements which include the additional expenses the company will incur as a result of implementing the waiver.

4. On July 19, 1983, this Commission issued a Public Notice inviting interested parties to comment on the merits of the Petition as it related to Illinois Bell or the industry as a whole. Eight parties filed comments: the Illinois Commerce Commission, the Virginia State Corporation Commission (Virginia), the People of the State and the Public Utilities Commission of the State of California (California), Mountain Bell filing for itself, Northwestern Bell and Pacific Northwest Bell, the GTE Service Corporation (GTE), and Continental Telecom, Inc. (Contel). Three parties filed reply comments: Illinois Bell, Contel and Central Telephone Company (Contel).

5. Illinois Bell argues that the requested waiver is in the public interest. It states that the waiver decreases the amount of time that the entire body of its present and future customers must support the embedded investment in this account. Further, it states that Illinois Bell customers in general will benefit from a more rapid reduction in the rate base. Finally, Illinois Bell argues that the change is consistent with another Illinois Commerce Commission decision on May 4, 1983, ordering an independent telephone company to change the inside wiring amortization period from a ten year period ending November 1, 1991, to a five year period ending December 31, 1986.

6. Of the remaining parties who filed comments, six support Illinois Bell's petition and two oppose it. All three reply comments support Illinois Bell's request. Contel, while generally supporting the petition, believes it should go a step further and *require* rather than merely permit the telephone companies to utilize a shorter amortization period. Contel also submits that a preferable date by which all telephone carriers must complete the amortization of embedded

[2] A four year transition period was established to phase in this change. Under this approach 25% of these costs were to be expensed in year one, 50% expensed in year two, 75% in year three, and 100% in year four. Also, carriers were allowed in certain instances to "flash-cut," i.e., start immediate 100% expensing of these costs, with state approval.

inside wiring is December 31, 1987, the deadline the Commission has proposed to complete deregulation of embedded customer premises equipment (CPE) in the *Notice of Proposed Rulemaking* in Docket No. 81–893, 48 Fed. Reg. 29891, released June 21, 1983.[3] It also states that it is the date on which the interstate revenue requirement associated with CPE is to be reduced to zero for separations purposes.

7. California and Virginia oppose shortening the amortization period. Virginia asks the Commission to recognize each state's authority to employ a shorter period in which to amortize the costs of inside wiring. California states that a shortened amortization period would not result in a speedier capital recovery to a telephone company unless the amortized expenses are reflected in the company's rates. California would be less concerned if this petition were limited to Illinois Bell and the State of Illinois. The Illinois Commerce Commission supports Illinois Bell's petition. It stops short, however, of committing to adopt specific intrastate rates for Illinois Bell because it has a rate proceeding now pending.

8. We conclude that it is in the public interest to grant Illinois Bell's petition, subject to the Illinois Commerce Commission's approval of rates including the additional revenue requirement involved. This approach is consistent with the spirit of Docket No. 79–105, *Expensing of Station Connections*, wherein we establish the ten year amortization period for station connection-inside wiring. The major thrust behind that decision was our desire to redistribute station connections costs to the cost-causative customer as quickly as possible. Our initial proposal called for an immediate move to full expensing of inside wiring.[4] However, based on comments received, we concluded that this approach might produce an undeserved burden on some carriers. Thus, we changed to a phase-in approach under which carriers could shift to full expensing over four years, starting October 1, 1981, with embedded investment being amortized over 10 years. However, we still sought flexibility for the companies and the states by allowing carriers, with state approval, to move immediately to full expensing of new inside wiring effective October 1, 1981. We also allowed companies to make these changes earlier in 1981, if they so chose. Finally, we called for the removal of all inside wiring from the plant accounts by October 1, 1991, using a flash-cut approach or September 30, 1994, using a phase-in approach.

9. Most of the respondents are not opposed to our granting the waiver to Illinois Bell. Further, the change is consistent with the Commission's goal of removing the historical CPE base and related

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[3] On November 23, 1983, the Commission adopted a Report and Order in Docket No. 81–893 which does not include a specific completion date for the deregulation of embedded CPE.

[4] Notice of Proposed Rulemaking in *Expensing of Inside Wiring*, 44 Fed. Reg. 48988 (1979).

equipment from regulation on an expedited basis. However, since a majority of the revenues necessary to cover this change must be established at the state level, we will condition our approval of the waiver on the Illinois Commerce Commission's approval of the change. Thus, we are approving the waiver subject to the Illinois Commerce Commission's determination that the change is in the state's best interest, and the establishment of rates to cover the change.

10. We turn now to the possible applicability of our decision to the industry as a whole. As indicated above, we are generally in favor of the faster write-off as a means to hasten the removal of the historical CPE base and related equipment from regulation. Also, the faster write-off would generate long-term rate savings benefits to the ratepayers since the investment would be removed from the rate base earlier than originally intended. Overall, the savings in return on investment would exceed the additional expense incurred in the early years. For instance, according to AT&T, if this change were applied to the total Bell System, there would be an additional revenue requirement of approximately $1.8 billion in 1984, $1.6 billion in 1985 and $1.4 billion in 1986. However, the estimated revenue savings over the final four years (1987–1991) would approximate $1.95 billion per year for a net savings overall through 1991 of $3.0 billion. Approximately 72.8% of the estimated costs and savings relates to intrastate revenue requirements. Therefore, we are unwilling to adopt Contel's proposal and unilaterally impose the shorter amortization period on the states. We will, however, be favorably disposed to grant similar waivers for those carriers who apply, if they have state approval. We find that this approach adequately addresses the concerns of both California and Virginia by leaving the ultimate approval with the states.

11. Accordingly, IT IS ORDERED, that pursuant to Sections 4(i) and 4(j) of the Communications Act of 1934, Illinois Bell's Petition for Waiver of Section 31.232(b) of the Commission's Rules and Regulations, 47 C.F.R. 31.232(b), IS GRANTED, subject to state approval of an amortization period for inside wiring ending December 31, 1986.

12. IT IS FURTHER ORDERED, That the Secretary shall cause to be served on each state commission having jurisdiction over intrastate communications service, a copy of this Memorandum Opinion and Order.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Dual City Identification
Station Identification

Section 73.1201(b)(2) of the Commission's Rules amended to permit a broadcast licensee to mention any additional community in its official station identification, provided only that the station's community of license is named first. Section 73.1201(b)(3) of the Rules concerning promotional identifications by broadcasters deleted in its entirety as being unnecessary.
–Multi-City Identification
BC Docket No. 82–374

FCC 83–487

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of Amendment of Section 73.1201(b)(2) of the Commission's Rules—Additional City Identification.	BC Docket No. 82–374

REPORT AND ORDER
(PROCEEDING TERMINATED)

(Adopted: October 19, 1983; Released: November 1, 1983)

BY THE COMMISSION: COMMISSIONER QUELLO ABSENT.

Background

1. On July 1, 1982, we adopted a *Notice of Proposed Rule Making* in this proceeding proposing the alteration of our rule concerning multi-city identification by broadcasters.[1] Under Section 73.1201(b)(2) of the Commission's Rules, a licensee must identify itself with its community of license. If it wishes to mention other communities in its official identification, it must request such authority from the Commission in an informal application. Such requests are routinely granted provided that the additional communities are located within the requesting station's principal-city signal contour. The Commission also has considered factors in addition to signal coverage, including "mutuality" (*i.e.*, whether the opposing station would be eligible for additional city identification) and the viability of the requesting and opposing stations, in deciding additional city identification cases.

[1] FCC 82–305, released July 23, 1982, 47 Fed. Reg. 32957, published July 30, 1982.

2. The *Notice* in this proceeding proposed two alternative changes in the substance and procedure for obtaining authority for multi-city identification. The first option was to retain the coverage requirement but to permit licensees to certify to the Commission that they meet the coverage standard. This would eliminate the application procedure and would permit the licensee to commence multi-city identification without further Commission action or review. Under this approach, signal coverage alone would govern eligibility and consideration of such non-technical factors as mutuality and viability would be eliminated. The second option was to eliminate both the application procedure and the coverage requirement, thus permitting licensees to identify by their community of license followed by any other community or communities that they selected, irrespective of their signal coverage of such additional communities. Comments were received with respect to both of these proposals. Other alternatives also were suggested by commenting parties.

Comment Summary

3. *Certification.* Comments supporting the certification option stress the speed, efficiency, and cost effectiveness of such a procedure. It is asserted that the current rule contains a specific guideline governing authorization of multi-city identification and that most multi-city applications are routinely granted. Thus, it is contended that the application procedure is completely unnecessary. Indeed, at least one commenter suggests that the Commission's approach in station identification matters has largely been one of certification already. Puerto Rico Broadcasting, Inc. (PRBI), however, recommends that the Commission utilize actual coverage, rather than predicted coverage, as the standard should the certification procedure be adopted. It contends that actual coverage has been utilized for this purpose in the past.[2] It also contends that the use of actual coverage would conserve Commission resources by eliminating most instances in which authorization for multi-city identification is sought and granted but is subsequently challenged on actual coverage grounds.[3] Under PRBI's proposal, waivers could still be sought in cases where there is no actual encompassment, but where other factors would support multi-city identification authorization.

4. Those opposed to the certification proposal argue that the current application process is neither costly nor burdensome given

[2] PRBI cites *Ponce Television Corp.*, 88 FCC 2d 1081 (1982), where the Commission withdrew multi-city identification authorization because terrain factors resulted in a large portion of the added community being shadowed. Predicted coverage had indicated that the entire community was encompassed by the applicant's city-grade contour.

[3] These would be cases similar to *Ponce Television Corp., supra,* in which actual coverage is not provided although it is predicted.

that only about 100 such applications are filed each year and that most of these are routinely granted. Accordingly, it is asserted that any administrative economies that might result from elimination of the application process would be outweighed by the consequences of such action—the disregard of public interest considerations which in the past warranted denial of multi-city identification permission irrespective of coverage. In any case, Channel Nine of Orlando (Channel Nine) asserts that administrative convenience does not provide a basis for abandoning prior policy.[4] Telemundo, Inc., argues that confusion to the public could result from a certification procedure. Specifically, it is alleged that the procedure could increase the likelihood of a station commencing multi-city identification and shortly thereafter changing its method of station identification. Such a change would be required where, for example, the Commission rescinds the certification based on new information indicating a lack of requisite coverage of the added community.

5. *Elimination of the Coverage Requirement.* Several commenters express support for the second option—the elimination of the coverage requirement as well as any application or authorization procedure. These commenters express the view that the decision to implement multi-city identification is a business decision which should be made by the broadcasters who run the risks inherent in making such decisions. Both the existing rule and a certification procedure, it is asserted, unjustifiably interfere with the play of free market forces without providing any countervailing benefit to the public. This option would permit broadcasters to function more effectively by allowing them to respond to the demands and incentives of the marketplace and would eliminate unnecessary administrative procedures, thereby conserving Commission resources. Adequate protection against abuse exists, these commenters assert, given the Commission's policies requiring licensees to deal candidly and truthfully with the public and prohibiting the use of inaccurate, misleading or exaggerated coverage maps or audience claims. Furthermore, stations would continue to owe their primary service obligation to their community of license without regard to their mode of official station identification. Moreover, the argument continues, should a licensee utilize a method of identification that was deceptive or misleading it could face civil penalties. The National Radio Broadcasters Association (NRBA) argues that neither advertisers nor the public needs the Commission to protect them from false coverage claims. Advertisers do not purchase air time based upon a station's official identification announcement. Rather, they rely on professional specialized market surveys and audience ratings studies. The public, NRBA asserts, can test

[4] In support of its position, Channel Nine relies on *New Castle County Airport Commission* v. *C.A.B.*, 371 F.2d 733 (D.C. Cir. 1966).

coverage claims by merely turning on the radio. In no case, it concludes, should the Commission be in the business of protecting advertisers who are well able to protect themselves with the use of ordinary diligence.

6. A number of commenters strongly oppose eliminating the current requirements. They contend that permitting stations to identify by any community (in addition to their community of license) would distort, not mirror, the marketplace because identification would not accurately reflect reality. The coverage requirement is said to act as a limiting factor so that unreasonable city identification claims cannot be made and so that unnecessary confusion in the audience's mind as to the market area from which a given station originates can be minimized. Elimination of the coverage requirement is seen by the National Association of Broadcasters (NAB) as indicating a Commission movement away from the policy of encouraging local service. Channel Nine suggests that elimination of the coverage requirement would undermine public and advertiser reliance on the integrity of station identification claims. Channel Nine also believes that this option would constitute an abandonment of the Commission's longstanding policy against false and deceptive practices by licensees. Market forces will not prevent such practices, according to Telemundo, because stations will utilize any means "that may afford any shred of credibility" to their attempts "to enlarge upon their status or stature as competitors."

7. Commenters also question whether this option would result in any savings to the Commission or the public in general. Channel Nine argues that administrative savings would not result because the abandonment of the coverage requirement would likely generate numerous complaints and proceedings. By contrast, retention of the coverage requirement, which provides a known and rational basis on which to judge the reasonableness of multi-city identifications, would avoid such disputes. PRBI contends that there also would be no savings to the public because it is less costly to enforce the existing straightforward rule than it would be to pursue the substantial civil litigation that would result from adoption of the proposed "market" approach. Telemundo believes that the abandonment of the coverage requirement also would mislead the public and would result in audience guides, newspaper listings and rate and data service information becoming confused and inconsistent as the standard for multi-city identification and the meaning of such identification would no longer be certain. Finally, it is asserted that any change in the current rule is unnecessary because stations currently may identify with communities in their lesser coverage areas in station promotional announcements, so long as they give their official identification as required.

8. *Alternative Proposals.* A number of commenters submitted

alternative proposals or made suggestions for modification of our own proposals. Telemundo, for instance, suggests that the Commission adopt a notification procedure instead of a certification procedure. Under this proposal, a licensee desiring to add a community to its official identification would notify all licensees and permittees with broadcast facilities licensed to communities within 15 miles of the city to be added. These licensees would have 30 days in which to file objections with the party making the notification. That party then would submit the notification and the responses to the Commission for approval or denial of multi-city identification authorization. If no objections were received in response to the notification, the licensee could commence multi-city identification 5 days after the 30 day objection period had passed. Thus, the Commission would be relieved of receiving and processing applications in the vast majority of cases that are uncontested.

9. A group of joint commenters proposed that the Commission retain the coverage requirement for radio but permit all television stations in a given market to identify with all other communities that comprise that market as defined by Arbitron's Area of Dominant Influence. According to the joint commenters, this approach would recognize that television is a wide area or regional type of service in which stations from different communities are typically perceived by advertisers, advertising agencies, other television stations and the public as serving a single market. It is argued that this makes the city-grade coverage requirement unnecessary for television.

10. Several commenters that generally support the certification option ask that it be supplemented by a post-certification review process through which pertinent objections to any certification could be presented and considered by the Commission on a case-by-case basis. Examples of such pertinent objections, in these commenters' view, would be a subsequent showing that definitively disputes "the essential facts" on which the certification was based, a showing of lack of actual or predicted coverage, extrinsic evidence that the certification is part of a de facto reallocation attempt, or a demonstration that error or misrepresentation was involved. Absent such review, NAB sees the certification option as another "step in an unlawful FCC trend toward neglecting the allocations and service needs of small communities and giving less concern to the statutory mandate of Section 307(b) of the Communications Act." Specifically, NAB fears that by eliminating consideration of factors other than signal coverage, the Commission will be opening the door to de facto reallocation of facilities contrary to Section 307(b) and longstanding Commission policy. Finally, a number of commenters suggest that, regardless of the coverage standard adopted in conjunction with a certification process, a waiver procedure should be made available for stations that do not meet the required coverage criteria but

whose unique market or coverage circumstances might nevertheless warrant authorization for multi-city identification.

Discussion

11. *Elimination of the Coverage Requirement.* Having reviewed the record in this proceeding, we are convinced that the signal coverage requirement imposed by Section 73.1201(b)(2) of the Rules in connection with additional city identification by broadcasters is unwarranted. Accordingly, we are amending this provision to permit a broadcaster to include in its official station identification the name of any community or communities that it selects, irrespective of the level of signal coverage provided to such communities. Neither application nor notice to the Commission in connection with changes in a station's mode of identification pursuant to this amendment will be required.

12. Our decision to eliminate the coverage requirement is motivated by several considerations. First, we perceive no legitimate regulatory need for the restriction. To the extent that the current rule is intended to protect advertisers from possibly being misled as to the coverage of a station, it unnecessarily and inappropriately involves the Commission in the economic relationship between a broadcaster and its advertisers. As we recently stated in our *Policy Statement and Order* ("Elimination of Unnecessary Broadcast Regulation"),[5] advertisers are neither required to nor likely to rely on station claims in determining coverage. Rather, they typically utilize readily available and sophisticated market survey data to ascertain the extent and demographic composition of a given station's audience. In any event, we found, advertisers have recourse to private legal remedies should they be defrauded by false coverage claims or representations. These considerations led us to eliminate our former policies concerning misleading coverage claims and distortion of audience ratings by broadcast licensees. It is even less likely, in our view, that advertisers will be misled by a station's official identification, regardless of what communities a licensee might choose to include in its announcement.

13. We also do not believe that eliminating the coverage requirement will pose any appreciable risk of harm to the public. In this regard, we note that a station will still be required to name its community of license first among the communities listed in its official station identification, thus providing a means of determining the station's location. Furthermore, contrary to some commenters' speculative contention that unreasonable station identifications will occur if the coverage requirement is deleted, we think that market forces and common sense will prevent stations from identifying with communities which they do not serve or have any connection with.

[5] FCC 83–339, released August 2, 1983, 94 FCC 2d 619.

In any event, even were a licensee to identify with a community which it does not serve, we can see no serious harm that would warrant Commission intervention. Those listeners or viewers routinely receiving the station are likely to be familiar with its general location, and those not receiving the signal cannot be misled by such an identification.[6]

14. We also disagree with NAB's contention that elimination of the coverage requirement will result in a movement away from the policy of encouraging local service. As we have stated in past cases and in the *Notice*, the inclusion of additional communities in a station's official identification does not alter the station's location or its obligation to provide satisfactory service to its community of license. *See, e.g., WTSP-TV, Inc.*, 48 RR 2d 1289 (1981). Consequently, if a station fails to meet its primary service obligation to its community of license, the matter would be considered in connection with the station's application for renewal of its license. Neither the substance nor procedure of this approach is affected by the changes we are adopting here. Additionally, NAB's argument that elimination of the coverage requirement will open the door to de facto reallocation of facilities in unpersuasive in view of our recent action in BC Docket No. 82–320[7]. In that proceeding, we abolished the de facto reallocation policy, concluding that reliance on our various licensing rules[8] would achieve the intended objectives of the policy while avoiding the unintended and unwanted results which the policy had engendered. *A fortiori*, retention of our existing identification rule, itself encumbered by unwanted effects, cannot be justified on the grounds that it is essential to prevent de facto reallocations.

15. In contrast to our conclusion that no substantial public interest purpose is served by retaining the coverage requirement, we find that adverse effects may result from its retention. Specifically, we are concerned that the current rule unnecessarily interferes with market forces, possibly skewing competitive relationships to the detriment of the public. Many stations, for example, provide service to communities beyond their principal-city coverage contour and

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[6] To the extent, of course, that a licensee's use of inaccurate additional city identification results in judicial or agency findings of a violation of law, we will continue to consider such findings. *See Violation of Laws of USA by Station Applicants*, 42 FCC 2d 399 (1951). However, the relevance of these situations to licensee character evaluation, and indeed the more general question of whether the Commission should continue to consider even adverse findings where, as here, the activities are primarily business-related rather than broadcast-related, will be resolved in the pending proceedings in Gen. Docket No. 81–500, Policy Regarding Character Qualifications in Broadcast Licensing, 87 FCC 2d 836, 848 (1981).

[7] *Report and Order* in BC Docket No. 82–320, FCC 83–81 (released March 14, 1983), 53 RR 2d 681, 48 Fed. Reg. 12094, published March 23, 1983.

[8] These rules require a licensee to provide city-grade service to its community of license, to locate and maintain its main studio within its community of license and to provide programming responsive to the needs of its community of license.

often generate significant advertising revenues in these areas. Yet, under current restraints, these stations cannot reflect this marketplace relationship in their official station identification.[9] To the extent that this situation artificially protects some stations from competition, it removes what may be a healthy competitive incentive for the protected station to improve its service to the public.[10]

16. Further, the existing rule imposes burdens on the Commission and its licensees, both in terms of the application process now specified and in terms of the substantial efforts and resources consumed in contested cases in this area.[11] Given our finding that no significant public interest purpose underlies the current requirement, these burdens are simply not justified.

17. We are also eliminating consideration of several non-technical factors that previously could have precluded multiple city identification. Concerns such as "mutuality" and the viability of the requesting station are plainly moot in view of our decision to eliminate the coverage requirement and to permit stations to identify with any additional communities which they select. Furthermore, we find that entertaining objections to additional city identification based upon the viability of the opposing station, as in *Sudbrink Broadcasting, Inc. of Floridav. F.C.C.*, 509 F. 2d 418, (D.C. Cir. 1974), is no longer advisable. As we noted earlier, we see no legitimate reason to expend Commission resources to protect stations from the competition caused by additional stations identifying with a particular community. In most cases, these stations will be serving the community in question and the added competition may well inure to the benefit of the public.

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[9] *Thomas Radio Co.*, 51 RR 2d 1151 (1982), *aff'd*, *Thomas Radio Co.* v. *F.C.C.*, Case No. 82–1828 (D.C. Cir., decided August 30, 1983), exemplifies this untoward result. In that case, station WOAY(AM), Oak Hill, West Virginia, requested and was denied permission to identify as Oak Hill-Beckley, West Virginia, because the station failed to place a city-grade signal over all of Beckley. In particular, the station did not place a 25 mV/m signal over the business areas of Beckley, although it placed the requisite 5 mV/m signal over the residential areas of the community and provided at least that level of service to the business district as well. Moreover, WOAY apparently was deriving about half of its advertising revenues from Beckley merchants. On appeal, the court affirmed our decision to deny WOAY's request, basing its affirmance on the limited scope of judicial review permitted in such cases. However, the court also questioned the soundness of the Commission's reasoning, stating that "the FCC's order . . . demonstrates very little practicality, and we are, therefore, encouraged by the agency's assurance to us that it is undertaking a reformulation of its policies on dual-city identification." Slip op. at 8.

[10] We acknowledge that the competitive impact of a particular mode of station identification is uncertain and may well be rather small in terms of generating advertiser or audience support. This very uncertainty, however, is at once what disturbs us about intervening regulatorily in this area and reinforces our conclusion that the marketplace mechanism is best suited to deal with the matter.

[11] *See, e.g.*, *Thomas Radio Co.*, *supra*, n.8, slip op. at 8.

18. *Certification.* Our decision to eliminate the coverage requirement altogether clearly renders consideration of the certification option raised in the *Notice*, and the variants of this approach suggested in the comments, unnecessary. Moreover, we do not believe that any form of notification to or prior review by the Commission should be required in connection with stations commencing or terminating multiple city identification. We discern no regulatory need for such procedures and conclude, therefore, that the burdens which they would impose on the Commission and its licensees are unwarranted.

19. *Additional Matters.* Our action permitting stations to identify with any community or communities that they wish vitiates the purpose of Section 73.1201(b)(3) of the Rules. That section provides tht a licensee shall not in its identification announcements, promotional announcements or in any other broadcast matter, attempt to lead its audience into believing that the station has been authorized to identify officially with communities other than those approved by the Commission pursuant to Section 73.1201(b)(1) and (2) of the Rules. Because such approval is no longer required, this constraint is now academic. Accordingly, we are deleting Section 73.1201(b)(3) of the rules in its entirety. We wish to emphasize, however, that this action is ministerial in nature and in no way implies our approval of station identifications designed to confuse the public as to a station's community of license. On the contrary, Section 73.1201(b)(2) continues to require that a station's community of license be listed first among the communities named in its official station identification.

20. In sum, we believe that our action eliminating the coverage requirement in connection with multiple city identification by broadcasters will relieve appreciable burdens on both licensees and the Commission. Moreover, this action will also promote a more competitive broadcast environment, thereby ultimately benefitting the industry and the public.

Final Regulatory Flexibility Analysis

I. *Need for and Purpose of the Rule.*

21. The purpose of the instant amendment of Section 73.1201(b) of the Commission's Rules is to eliminate unnecessary substantive and procedural requirements that currently must be satisfied before broadcast licensees may include additional communities in their official station identifications. Specifically, this amendment eliminates the requirement that a station place a city-grade signal over any additional communities with which it wishes to identify. Such a restriction was found to serve no legitimate regulatory purpose, yet it often prevented stations from identifying with communities which the stations served and from which the stations derived appreciable advertising revenues. Furthermore, the subject amendment deletes

the current application, review and approval process which imposed unwarranted burdens on broadcast licensees and the Commission's staff. Finally, the amended rule eliminates consideration of various non-technical factors that previously could have precluded multiple-city identification.

II. *Flexibility Issues Raised in the Comments.*

22. The most significant flexibility related issue raised in the comments was support for the option adopted in this *Report and Order*, which eliminates both the coverage requirement and the existing application, review and approval process. Some commenters felt, however, that the coverage rule should be retained, while the application procedure should be replaced by a less burdensome alternative, such as the certification option proposed in the *Notice*.

III. *Significant Alternatives Considered but Not Adopted.*

23. Two significant alternatives were considered. The first was the alternative mentioned immediately above, under which a station could include additional communities in its official identification upon certifying that its principal-city signal contour encompassed these communities. The second alternative, which was first proposed in the comments, was to adopt a notification procedure as fully described in paragraph 8, *supra*. These alternatives were both rejected because they were premised upon retention of a coverage requirement that we found to serve no viable regulatory purpose.

24. Accordingly, IT IS ORDERED, that Section 73.1201(b) of the Commission's Rules, 47 C.F.R. § 73.1201(b), IS AMENDED, as set forth in the attached Appendix, effective December 8, 1983.

25. Authority for this action is contained in Sections 4(i), 303(g) and 303(r) of the Communications Act of 1934, as amended.

26. For further information on this proceeding, contact Andrew J. Rhodes, Mass Media Burea, (202) 632–7792.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX

47 C.F.R. § 73.1201 is amended by revising subparagraph (b)(2), and removing subparagraphs (b)(2)(i), (b)(3) and the Note preceding paragraph (c), to read as follows:

§ 73.1201 Station identification

* * * * *

(b) * * *

(1) * * *

(2) A station may include in its official station identification the name of any additional community or communities, but the community to which the station is licensed must be named first.

* * * * *

Cable, Pacific
Notice of Inquiry
Satellite Communications, International, Policy Re: International

Notice of Inquiry adopted into policies to be followed in the authorization of Common Carrier facilities to meet Region Telecommunications Needs during the period 1981–1995.
—*Pacific Telecommunications*
CC Docket No. 81–343

FCC 83–515

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of Inquiry into Policies to be Followed in the Authorization of Common Carrier Facilities to meet Pacific Telecommunications Needs During the Period 1981–1995.	CC Docket No. 81–343

NOTICE OF INQUIRY

(Adopted November 8, 1983 Released November 21, 1983)

BY THE COMMISSION: COMMISSIONER RIVERA ABSENT.

1. This Notice of Inquiry initiates the second phase (phase II) of the comprehensive facilities planning process in the Pacific Ocean Region (POR) for the period 1981 through 1995. During phase II of this proceeding, we shall develop policies and guidelines for the construction and use of cable and satellite facilities in the POR during 1987–1995. The first phase (phase I) of this planning process focused on facilities needs in the POR for the 1982–1986 period and was concluded in December 1982.[1] This notice will summarize the phase I orders, describe the recent developments since the conclusion of phase I, and identify the issues to be considered in phase II of this proceeding.

I. *Background: The Phase I Orders*

2. On June 1, 1981, we adopted a Notice of Inquiry[2] which initiated a comprehensive planning process in the POR for the 1981–

[1] Pacific Planning (Report and Order) 47 F. R. 57040 (December 22, 1982).
[2] Pacific Planning (Notice of Inquiry) 46 F. R. 31286 (June 15, 1981).

1995 period. We later adopted a Notice of Proposed Rulemaking in this proceeding (NPRM),[3] by which we issued for public comment our tentative conclusions about facilities planning and use in the region. The tentative conclusions reached were limited to 1982–1986 because of our decision to bifurcate this proceeding into two phases.

3. In our *Report and Order* terminating phase I, we reached three major conclusions.[4] First, we found that the acquisition of circuits by U.S. carriers in the ANZCAN cable system[5] serves the public interest. Specifically, we authorized U.S. carriers to acquire both permanent and/or temporary IRU[6] interests in 652 half circuits and 196 whole circuits in ANZCAN North and 608 half circuits in ANZCAN South. Second, we found that construction and use of analog HAW-4 and TRANSPAC-3 (TPC-3) cables would not serve the public interest. Third, we found that utilization of INTELSAT's in-orbit spare satellite as an operational spare satellite during the mid-1980's would serve the public interest.

4. We deferred the following issues until the second phase of the process: (a) U.S. carriers' forecasted circuit demands and circuit requests for the 1987–1995 period; (b) alternative facility plans proposed for construction during that period; and (c) the proposed introduction of a fiber optic TPC-3 cable in 1988 and the configuration thereof. During the first phase, the Department of Defense (DOD) and the National Telecommunications and Information Agency (NTIA) strongly supported the introduction of a fiber optic TPC-3 cable which would be routed from Hawaii to Guam and then to Japan. Both parties asserted that the national security and commercial interests of the United States would best be served by the routing of the TPC-3 cable system through Guam.

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[3] Pacific Planning (Notice of Proposed Rulemaking) 47 F.R. 21868 (May 20, 1982).

[4] We also reached the following other conclusions:

(1) AT&T's Master Plan and incorporation of the shortfall/longfall approach is reasonable;

(2) exemption of the IRC's from specific loading criteria would serve the public interest;

(3) exemption of Hawaiian Telephone Company's private line circuits from a specific loading methodology serves the public interest; and

(4) that a standard costing methodology need not be adopted in phase I of the planning process.

[5] The ANZCAN cable will be constructed and owned by telecommunications entities of Australia, Canada, France, the Federal Republic of Germany, New Zealand, the Independent State of Papua, New Guinea, the Philippines and the United Kingdom.

[6] The term IRU, or indefeasible right of user refers to a type of ownership of transmission facilities in which the IRU holder has most of the indicia of ownership, but lacks the right to control the facility or, depending on the particular IRU contract, any right to salvage.

II. *Recent Developments*

5. By letters dated July 1, 1983, the staff requested updated information from AT&T and Comsat regarding the status of facilities planning in the POR. AT&T and Comsat responded to this request on July 25, 1983. In its response, AT&T stated that it, together with the other United States International Service Carriers (USISCs), is currently engaged in a series of meetings with its Pacific region correspondents to discuss facilities planning. The purpose of these meetings is to forecast industry circuit requirements, to develop alternative facility plans that would satisfy these requirements and to analyze these plans in terms of cost and other relevant considerations.[7] AT&T also asserts that the parties to these meetings are considering various configurations of the proposed fiber optic TPC-3 cable and are taking into account both NTIA's and DoD's concerns regarding a Guam landing point.

6. Comsat's response indicates that because the INTELSAT V series satellites have had a higher rate of successful launches and placement than anticipated, an INTELSAT V satellite will be available by early 1984 to serve as the Pacific Spare Operational Satellite. By year end 1984, an INTELSAT V satellite will be relocated from the Atlantic Ocean Region to serve as the Pacific Primary satellite. It will reach the end of its design life in 1987 and will be replaced with another INTELSAT V satellite, relocated from the Indian Ocean Region.

7. On July 28, 1983, the staff issued a Public Notice soliciting comments from interested parties and persons on the following items:

(1) AT&T's and Comsat's July 25 filings;

(2) various configurations of the proposed fiber optic TRANSPAC-3 cable system;

(3) the date for the formal initiation of the second phase of the POR planning process; and

(4) any other matters related to this proceeding.

Comments in response to this Notice have been received from Hawaiian Telephone Company (HTC); Western Union Telegraph Company (WU); State of Hawaii (Hawaii); RCA Global Communica-

[7] At a meeting held in April 1983, the USISCs and their foreign correspondents developed a long range bilateral circuit forecast and established a small working group to develop and analyze alternative facility plans. A second meeting involving modeling experts was held in May 1983 to discuss the planning models to be used. A meeting of the working group was held in August 1983 to analyze alternative plans produced by the planning models. A meeting among the principals' representatives' was held in September 1983 to review the analysis of the alternative plans developed by the working group. A meeting of principals is scheduled for January 1984 to identify a set of mutually acceptable plans.

tions, Inc. (RCA Globcom); ITT World Communications Inc. (ITT); Department of Defense (DoD); and the National Telecommunications and Information Agency (NTIA). All of the comments support the prompt initiation of the second phase of the Pacific planning process. DoD and NTIA strongly urge that routing the TPC-3 cable through Guam and then to Japan would best serve our national defense, security and commercial interests. These comments, as well as AT&T's and Comsat's June 25 filings, are summarized in greater detail in Appendix I to this Notice.

8. In its comments, NTIA states that a Guam landing point will provide the United States with operational flexibility, a gateway to the Far-eastern communications network and the shortest cable path between the U.S. mainland and all cable destinations in Asia with the exception of Japan and Korea. NTIA also maintains that a Guam landing point would ensure that the United States controls services to the Western Pacific countries. NTIA further states that a Guam landing point is essential to a competitive market for submarine cables. In the alternative, NTIA suggests that a deep-water branching point which splits U.S. traffic to Japan and Korea from that of Guam and the rest of the Pacific may be a reasonable compromise.

9. DoD states that it cannot support any plan for the TPC-3 cable which does not have a terminal point in Guam since Guam is DoD's communication hub in the Far East. According to DoD, circuits critical to defense communications connect Guam with U.S. military installations and activities in Southeast Asia, as well as in Japan and Korea.

III. *Scope of the Issues and Criteria for Evaluation*

10. The scope of this inquiry is expected to include an assessment of currently operating facilities in the region with a comparison of actual use relative to available capacity and design life. This should encompass cable systems in operation, international satellite facilities, and domestic satellite facilities capable of serving Hawaii. We expect in this inquiry to consider a full range of facilities alternatives capable of meeting projected traffic demands in the POR from 1987–1995.

11. Consistent with past practices, we intend to collect traffic data from U.S. carriers. In this regard we note that the volume of telecommunications traffic in the Pacific has grown considerably in recent years.

12. We will also request that the carriers update their alternative facilities plans submitted during phase I of this proceeding for the years 1987–1995. In this context, we shall address the issue of configuration of the proposed fiber optic TPC-3 cable. We shall examine the commercial, security and defense considerations favoring a Guam landing point. We shall balance these considerations

with other concerns including whether actual traffic would cover the cost of such a configuration. We shall also consider how a particular configuration of the TPC-3 cable can be integrated into the existing network of cables in the POR that provide service between the U.S. and the Far East.

13. All available transmission media and viable technological designs will be considered, as well as techniques for circuit multiplication and other methods for enhancing the efficiency of a facility. We also intend to address the issue of facilities use, and the restoration of service following a facility failure.

14. Consistent with the position that we took in Phase I, we intend to address the issue of loading and to review it for monitoring purposes, but we do not intend to specify loading criteria. In recent years, we have moved away from specifying any loading criteria and we intend to continue this policy as competition develops. We expect that as Comsat develops its own customer traffic base under our pro-competitive policies, the Commission will no longer have to monitor traffic loading. Rather, economic and service quality considerations will govern traffic loading under competitive market conditions. Thus, we believe the appropriate course for us to follow is to provide the U.S. carriers and Comsat with guidelines regarding the choice and use of major facilities, instead of stating a preference for a particular facilities construction and utilization plan. We intend these guidelines to define a range of acceptable alternatives for facilities use. The range defined should be narrow enough to protect the U.S. public from the consequences of excessive or inadequate facilities investment; yet, it should be broad enough to allow sufficient flexibility for the carriers and Comsat to vary the introduction of such facilities to meet the uncertainties inherent in the development of new technologies, varying demand conditions, and the requirements of foreign correspondents. Flexibility in our policy guidelines leaves room to accommodate our foreign partners and promotes the attainment of a consensus among the sovereign nations taking an active part in facilities planning for the POR.

15. We intend to conduct this inquiry on an expedited basis culminating in the issuance of a Report and Order specifying guidelines related to the facilities expected to be operational by 1995. Upon completion of the record compilation process, we expect to initiate the rulemaking stage of this proceeding.

16. In accordance with sound administrative practice and the Administration Procedure Act (5 U.S.C. Section 551 *et seq.*), we invite public participation by all interested parties in the form of written comments on any and all issues raised in this Notice. We are specifically requesting information and public comment on the following issues:

(1) U.S. carriers' forecasted circuit demands and circuit requests for the 1987–1995 time frame;

(2) alternative facilities plans proposed for construction during the 1987–1995 period;

(3) the proposed introduction of a fiber optic TPC-3 cable in 1988 and the configuration thereof;

(4) any critical dates by which facilities decisions must be made;

(5) scheduling of Public Meetings; and

(6) any other matters related to this proceeding.

17. We are also delegating authority to the staff to hold a series of public meetings at the Commission's offices with all parties for the purpose of expeditiously obtaining all of the planning information deemed necessary to compile a complete record in this proceeding. These meetings will be held concurrently with and subsequent to the comment period. Parties are invited to participate in these public meetings. The meetings will begin as soon as possible after release of this Notice.

18. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 4(j) 214 and 403 of the Communications Act of 1934, 47 U.S.C. Section 154(i), 154(j) 214 and 403 (1970), and Section 201(c) of the Communications Satellite Act of 1962, 47 U.S.C. Section 801 (1970), that:

(A) the American Telephone and Telegraph Company, the Communications Satellite Corporation, ITT World Communications, Inc., Hawaiian Telephone Company, State of Hawaii, RCA Global Communications, Inc., TRT Telecommunications Corporation, Western Union International, Inc., Western Union Telegraph Co., FTC Communications Corporation., Department of Defense and National Telecommunications and Information Agency, are hereby made parties. We also will consider requests by other interested entities to be made parties to this proceeding.

(B) Comments and reply comments shall be filed according to the following schedule:

Comments	30 days from date of publication of the Notice in the Federal Register.
Reply Comments	45 days from the date of publication of the Notice in the Federal Register.

19. IT IS FURTHER ORDERED That the Commission's staff is delegated authority to hold public meetings at the Commission's offices from time to time, as may be necessary, to obtain information deemed necessary to develop such a record.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

APPENDIX I

RESPONSE OF AMERICAN TELEGRAPH AND TELEPHONE (AT&T) TO THE COMMISSION'S LETTER OF JULY 1, 1983

In its response, AT&T summarizes past Pacific Ocean Region planning meetings the

USISCs and foreign correspondents have held, describes the schedule of future planning meetings, and strongly supports initiation of the second phase of the Pacific Ocean Region Planning Process.

AT&T states that AT&T, the USISCs and foreign correspondents have met and continue to meet to: a) forecast industry circuit requirments in the Pacific, b) develop alternative facility plans to accomodate anticipated traffic, and c) analyze these plans on the basis of cost and other factors. In April 1983 USISCs and foreign correspondents met and developed bilateral circuit forecasts and established a small working group to develop and analyze alternative facility plans. In the May 1983 meeting, various planning models which the working group will use were discussed, cost information used in economic analysis of alternative plans was refined, and a preliminary group of various TPC-3 cable configurations were studied. AT&T reports that the alternative routings included: a) a direct cable between Hawaii and Japan, multipoint configurations and deep-water branching cable systems with possible terminal points in Hawaii, Guam, Japan, Hong Kong and the Phillipines.

AT&T reports that additional meetings will occur in August and September of 1983 and in January 1984. At the August 1983 meeting members of the working group will analyze alternative facility plans. In September the principals' representatives will convene to review the progress of the working group. The principals will meet in January 1984 to discuss the efforts of the working group and identify a set of mutually acceptable tentative facility plans.

In response to Commission's request for information on AT&T's corporate positions on timing, routing technology and cost of additional POR facilities, AT&T states that these issues are very fluid at this time and thus it is impractical for AT&T to formulate corporate positions on these issues. In addition, AT&T believes that disclosure of corporate positions could be detrimental to the effective participation of the USISCs in these meetings.

AT&T acknowledges that the Department of Defense and the Department of Commerce strongly advocates construction of a TPC-3 cable with a Guam landing point. AT&T notes that presently many configurations are under consideration, including plans which contain a Guam landing point. AT&T states that it will ensure that configurations reflecting the concerns of DOD and DOC will be fully considered. According to AT&T, each TPC-3 configuration will be analyzed in terms of economic considerations, traffic demand, technical alternatives, service reliability and quality.

AT&T suggests that the second phase of the POR should coincide with the January 1984 meeting so that mutually acceptable alternative plans arrived at in the January 1984 meeting can be included in the second phase of the Pacific Planning Process. AT&T states it will advise correspondents that the Commission is considering implementation of a second phase of the Pacific Planning Process and that alternative plans correspondents and U.S. telecommunications corporations arrive at will be included in the Commission's planning process.

RESPONSE OF COMSAT TO THE COMMISSION'S LETTER OF JULY 1, 1983•

Comsat reports that as a result of the Intelsat V series satellites having a higher rate of successful launches and placement than anticipated, an Intelsat V satellite will be available by early 1984 to serve as the Pacific Spare Operational Satellite (Spare satellite). It will replace the the IV-A satellite which is currently functioning as the Spare satellite. The V satellite will also provide maritime communication services for INMARSAT. The IV-A satellite will remain in the Pacific and be used for Intelsat leased service and dual polarization antenna qualification testing.

By year end 1984 the Intelsat IV-A satellite serving as the Pacific Primary satellite, will be replaced by an Intelsat V satellite relocated from the Atlantic Ocean Region. The Intelsat V primary satellite will reach the end of its design life by year end 1987

and will be replaced by that time with one of two other Intelsat V satellites which will be relocated from the Indian Ocean Region. The second Intelsat V satellite will be relocated to serve as a new Spare satellite. The former Spare satellite will remain as the Major Path satellite and will continue to provide INMARSAT service.

Comsat states that in 1985 Australia, Canada, Japan, Korea, New Zealand and the United States plan to operate 6/4 GHz antennas with the Pacific Spare satellite. By 1988 the Philippines and China will also operate 6/4 GHz antennas with the Pacific Spare satellite.

Comsat reports that Pacific Ocean Region demand for television and domestic leases, thin route services and business service after 1991 are currently under study. Comsat anticipates that definitive conclusions will be reached in one or two years.

In response to the Commission's question concerning the introduction of new modulation and voice encoding techniques, Comsat states that various techniques are under study and will be implemented over the next twenty years. However, Comsat does not believe that the introduction of these new techniques will have any impact on space segment facilities in the POR during this decade.

Comsat states the FDMA/CFDM/FM will be introduced into the Pacific Ocean Region in the next year. In addition, several administrations, notably Australia, Hong Kong and Japan are contemplating converting their terrestrial feeds to earth stations from analog to digital signals in the second half of the decade and have expressed interest in the early introduction of TDMA/DSI on the Pacific Primary satellite to accomodate their digital traffic. However, 1986 is the earliest time that Intelsat will introduce TDMA/DSI in the POR. In addition, Comsat notes that AT&T has no plans to install digital terrestrial feeds into ESOC West Coast earth stations.

Comsat reports that INTELSAT is also studying the potential for transponder capacity enhancement though the use of Amplitude Companded Single Sideband (ACSSB). Comsat, AT&T and the German Bundespost plan to begin operation field tests using INTELSAT space segment later this year, and results should be complete by early next year. Comsat states that it is too early to tell what effect this technology will have on Pacific planning.

CATV
Compliance Ordered
Employment, Equal Opportunity Rule

Direction letter adopted admonishing licensee for not fully implementing its EEO program. Licensee is required to submit an updated EEO program and periodic employment reports. —*Perry Cable TV Corp.*

FCC 83-558

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of

Mr. John H. Perry, III, President
P.O. Box 10297
275 West 10th Street
Riviera Beach, Florida 33407

The Equal Employment Opporunity (EEO)
Program of Perry Cable TV Corporation (Perry Cable).

(Adopted: November 23, 1983 Released: December 1, 1983)

Dear Mr. Perry:

This is in reference to the equal employment opportunity (EEO) program of Perry Cable TV Corporation (Perry Cable).

As you are aware, the Commission's rules require that cable television operators afford equal opportunities in employment to all qualified persons and that no person shall be discriminated against in employment because of race, color, religion, national origin, or sex. In order to determine whether equal opportunities in employment are indeed being afforded, our rules further provide that cable television operators submit an EEO program and Annual Employment Reports for each employment unit. As to these matters, we note that you filed the EEO program for the Riviera Beach employment unit on November 2, 1982, and that you have filed the required Annual Employment Reports.

Comparison of your 1981 Annual Employment Report for the

Riviera Beach employment unit with the relevant available labor force - 40.2% women, and 23.4% minorities[1] - disclosed the following: of 173 employees, 25 (or 14.5%) were women and 17 (or 9.8%) were minorities; while of 45 employees in the upper-four job categories (officials and managers, professionals, technicians and sales workers), 3 (or 6.7%) were women but none was a minority. Because of the substantial disparity between the number of women and minorities employed at Perry Cable and their presence in the labor force, the staff, in a letter dated September 13, 1982, requested information concerning 1981 employee rankings as well as hires, terminations, promotions, and recruitment efforts for the twelve month period preceding the 1980 and 1981 Annual Employment Reports. Your response, dated November 3, 1982, included Perry Cable's EEO program, its "Annual Equal Employment Opportunity Program Review" form and its "Personnel Policy" form. However, you did not provide any of the data requested; rather, you stated that you did not keep records of the race or national origin and sex of the persons hired, terminated, promoted or recruited.

In view of the foregoing, you were informed by letter of March 29, 1983, where the information sought by the Commission could be obtained. Specifically, with respect to the Commission's request for employee rankings by job title, race, sex and/or national origin, you were advised that it could be reconstructed from federally required employee records, such as those required by the Internal Revenue Service. *See* 29 C.F.R. §§ 31.6001 *et seq.* Further, it was noted that meaningful review of an EEO program's effectiveness could only be made if records concerning all employees were maintained. *See, e.g,* 41 C.F.R. § 60–2.25 (Office of Federal Contract Compliance). However, in your response of May 3, 1983, you stated that you were unaware of any federal regulations requiring maintenance of records which would provide the requested information. In any event, you claimed that you fully support equal employment opportunity and that your EEO program is one of the most thorough and comprehensive in the industry.

Finally, subsequent to the staff's letter of March 29, 1983, your 1982 Annual Employment Report was reviewed. Comparison of your full-time staff with the relevant labor force - 40.2% women, 23.4% minorities - disclosed the following: of 192 employees 68 (or 35.4%) were women and 7 (or 3.6%) were minorities, and of the 67 employees in the upper-four job categories, 5 (or 7.5%) were women but none was a minority. Thus, although your overall employment of women increased from 1981 to 1982, your employment of minorities

[1] According to the Florida Department of Labor and Employment Security, the West Palm Beach-Boca Raton SMSA labor force (which includes Riviera Beach), includes 19.7% Blacks, 3.5% Hispanics, and 0.2% other minorities.

decreased. Further, in neither the 1981 or 1982 report did you list a single minority in an upper-level job.

In our view, you have not demonstrated any serious effort to seek out, recruit and hire members of protected groups, nor have you demonstrated the taking of any step likely to result in increasing the presence of protected group members in upper-level jobs. Moreover, your employment statistics, especially for upper-level positions, suggest that your EEO program is only marginally effective with regard to women and totally ineffective with regard to minorities. Finally, your failure to maintain records of job applicants, hires, promotions and terminations makes it virtually impossible for you to evaluate your EEO program and take corrective action. Thus, in view of the foregoing, and in order to insure that your EEO program will be fully implemented, we are requiring that you respond to the following inquiries, submit four EEO progress reports, establish minority hiring goals, and a timetable in which to achieve them. Further, we admonish you to begin immediately maintenance of records which will allow you to evaluate your EEO program.

Accordingly, IT IS ORDERED, that Perry Cable TV Corporation, submit to the EEO Branch of the Mass Media Bureau's Enforcement Division, within thirty (30) days of the date of this letter, an original and one copy of the following:

(a) State the name and title of the official responsible for the implementation of the Riviera Beach employment unit EEO program.

(b) List the recruitment sources and explain the techniques Perry Cable proposes to use to increase the pool of minority and female job applicants at the Riviera Beach employment unit.

IT IS FURTHER ORDERED, that you submit to the EEO Branch within thirty (30) days of the date of this letter, an amended EEO program containing minority hiring goals, and female hiring goals for positions in upper-level jobs, and timetables for both with a plan of action to achieve them. These goals are to be numerical objectives fixed realistically, stating the number of hiring opportunities anticipated between now and December 1, 1984. The projected hiring goals should be the maximum that can be achieved by taking positive steps to attract as many minority and female applicants for *each* job opening as possible.

IT IS FURTHER ORDERED, that in order to monitor the effectiveness of your efforts, you submit to the EEO Branch an original and one copy of the following on or before May 15, 1984, November 15, 1984, May 15, 1985 and November 15, 1985:

(a) a list of employees as of the payroll period utilized for the 1984 Annual Employment Report, the first pay period in September 1984, the 1985 Annual Employment Report, and the first pay period in September 1985 for the Riviera Beach employment unit, by job title with part-time or full-time status indicated

(ranked from the highest paid to the lowest paid), Form 395A classification, date of hire, sex and race or national origin;

(b) a list of all persons hired as well as all those persons who applied for each position filled during the six months preceding the pay period for the list noted in subpart (a) for the Riviera Beach employment unit, indicating their referral or recruitment source, job title, part-time or full-time status, date of hire, sex and race or national origin;

(c) a narrative statement detailing Perry Cable's efforts to recruit for each position filled during the specified periods, including the identification of sources used for the purpose of increasing Perry Cable's pool of minority and female applicants.

Should you have any questions regarding this action, please contact Mr. Glenn Wolfe of the EEO Branch at (202) 632–7069.

BY DIRECTION OF THE COMMISSION
WILLIAM J. TRICARICO, *Secretary*

Competition, Common Carriers
Customer Premises Equipment
Deregulation

Report and Order adopted regarding procedures for the detariffing of embedded customer premises equipment owned by the Bell System and approving the capitalization of AT&T Information Systems in connection with the transfer of this equipment.
–*Second Computer Inquiry*
CC Docket No. 81–893

FCC 83–551

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	
Procedures for Implementing The Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry)	CC Docket No. 81–893
American Telephone and Telegraph Company, Request for Approval To Supplement the Capitalization of AT&T Information Systems in Connection with the Transfers of Embedded Customer Premises Equipment	File No. ENF 83–18

REPORT AND ORDER

(Adopted November 23, 1983; Released: December 15, 1983)

BY THE COMMISSION:

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I. INTRODUCTION AND BACKGROUND

A. *General Purposes and Concerns*

1. This proceeding[1] concerns the development of criteria and procedures for the removal of embedded customer premises equipment (CPE)[2] from regulated service in a manner which furthers the

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* Appendices D, E, F, and G are not included in the released version of this Report and Order. These appendices, however, have been filed with the Secretary of the Commission for inclusion in the official record of this docket. Appendix G also is included in File No. ENF 83–18.

[1] This proceeding was initiated through the release of a Notice of Inquiry on April 13, 1982. Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), CC Dkt. No. 81–893, Notice of Inquiry, 89 FCC 2d 694 (1982) (hereinafter Notice of Inquiry). On June 21, 1983, we released a Notice of Proposed Rulemaking. Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), CC Dkt. No. 81–893, Notice of Proposed Rulemaking, FCC 83–181, 48 Fed. Reg. 29891 (released June 21, 1983) (hereinafter Notice).

[2] For purposes of this proceeding, customer premises equipment includes any equipment provided by a common carrier and located on the premises of a customer, except that the term does not include overvoltage protection equipment, simple inside wiring, intrasystem wiring, coin-operated or other pay telephones, or multiplexing equipment used for the delivery of multiple channels to a customer. Notice at para. 1 n.2. We also note that any subsequent changes in this definition of CPE which may be adopted by the Commission would require application of the requirements of this Order to the resulting new category of embedded CPE. This docket applies to CPE provided by common carriers in any state, the District of Columbia, Puerto Rico, and the Virgin Islands. This Order disposes of issues relating to the embedded CPE base owned by AT&T or transferred to AT&T as a result of the divestiture, but does not address all issues relating to the embedded

principles articulated in *Second Computer Inquiry*.[3] In seeking to develop these criteria and procedures, we have focused on the following primary issues: (1) In the case of the American Telephone and Telegraph Company (AT&T), establishment of a general framework for the detariffing and transfer of embedded CPE to AT&T Information Systems (ATTIS)[4] in a manner which is consistent with the Communications Act of 1934, judicial precedents, and the policies we established in *Second Computer Inquiry*. Rules governing the valuation of the embedded CPE[5] must be included in this general framework. (2) Whether ATTIS should be subject to any conditions or requirements in connection with any transfer of the embedded base to ATTIS. (3) Determination of several tax and accounting questions which relate to the valuation of the embedded CPE base. (4) Whether intrasystem wiring should be detariffed and removed from regulated service together with associated embedded multi-line CPE. These issues constitute the central focus of this *Order*. In addition, we will determine whether AT&T's proposed supplement to ATTIS's capitalization in connection with the transfer of embedded CPE is consistent with the policies and provisions of *Second Computer Inquiry*.

2. The underlying premise of this proceeding has been articulated in *Second Computer Inquiry*:

> [W]e find that the tariffing of CPE in conjunction with regulated communications services has a direct effect on rates charged for interstate service. To the extent rates for interstate services bear costs attributable to carrier-provided CPE regulation serves to thwart the competitive provision of CPE. The continuation of tariff-type regulation over carrier-provided CPE neither recognizes the role of carriers as competitive providers of CPE, nor does it reflect the severability of CPE from transmission services. We conclude that CPE is a severable commodity from the provision of transmission services and that regulation of CPE under Title II [of the Communications Act of 1934] is not required and is no longer warranted. x100

Final Decision, 77 FCC 2d at 388. We emphasized in *Second*

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base of the Independent telephone companies or the record carriers. *See* para. 5 n.9, *infra*; Part XI.C., *infra*. For purposes of this proceeding, CBT and SNET are included among the Independent telephone companies.

[3] Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384 (Final Decision), *reconsideration*, 84 FCC 2d 50 (1980) (Reconsideration Order), *further reconsideration*, 88 FCC 2d 512 (1981) (Further Reconsideration Order), *aff'd sub nom.* Computer & Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982) (hereinafter CCIA v. FCC), *cert. denied sub nom.* Louisiana Pub. Serv. Comm'n v. FCC, 103 S.Ct. 2109 (1983).

[4] AT&T Information Systems, the subsidiary established by AT&T for the provision of CPE and deregulated services, was formerly named American Bell, Inc.

[5] For purposes of this proceeding, "embedded" CPE includes "all CPE owned by a carrier, including inventory, which is tariffed or subject to the separations process as of the bifurcation date [January 1, 1983]." Further Reconsideration Order, 88 FCC 2d at 513. We have defined "new" CPE as "[a]ny other CPE which is acquired by a carrier or manufactured by an affiliated entity after [the bifurcation date]." *Id.* at 528.

Computer Inquiry that "the terminal equipment market is subject to an increasing amount of competition as new and innovative types of CPE are constantly introduced into the marketplace by equipment vendors." *Id.* at 439. We also noted that consumers have been able to derive substantial benefits from these competitive forces in the CPE marketplace. Our assessment of this marketplace led us to conclude that "[c]ontinued regulation of CPE will not foster a competitive equipment environment. In the present environment in which CPE is marketed, we are hard pressed to proffer any statutory or public interest justification for rate regulation of carrier-provided CPE." *Id.* at 441. We reaffirmed this conclusion in subsequent rulings in *Second Computer Inquiry*, noting that the "continued provision of CPE by common carriers under regulation impedes the evolution of a truly competitive CPE market." *Reconsideration Order*, 84 FCC 2d at 65 (citing *Final Decision*, 77 FCC 2d at 440–46). We also pointed out that "there is generally no dispute that CPE should be provided on a competitive basis." *Id.*; *see also Further Reconsideration Order*, 88 FCC 2d at 513. In the *Notice* issued in this proceeding we alluded to the fact that we have pursued vigorously a policy of promoting competition in the CPE marketplace,[6] and we emphasized that "[i]t is our continuing objective to encourage [the] development of competition, and we are cognizant of the fact that the transitional plan which we adopt in this proceeding may have a bearing upon the future course of this development." *Notice* at para. 27. We also stressed that "we must keep squarely in view the fact that competitive market forces are increasingly rendering price regulation of CPE impractical and unwarranted. This compels that deregulation of the embedded base occur sooner rather than later." *Id.* at para. 84.

3. We thus take as our starting point our findings that the CPE marketplace is becoming increasingly competitive, and that continued regulation of CPE is not necessary and in fact could impede the further growth of this competition. In *Second Computer Inquiry*, however, as we pursued the question of the most effective means to carry out deregulation of the provision of CPE by carriers, we were led to the conclusion that distinctions must be drawn between new CPE and the embedded CPE base. We noted that:

> [V]arious petitioners have suggested a bifurcated transition plan that would enable regulators to address separately equipment which is embedded in the separations process and tariffed with the various States. We find this approach to be reasonable. It would allow for an orderly transition to deregulation of that equipment where significant dislocations are alleged to arise if detariffing is to occur by [the bifurcation date] . . . . The difficult transitional issues arise not in connection with the provision of new CPE, but in connection with the necessity to make adjustments to existing arrangements involving allocations of costs, investment and revenues associated with embedded equipment . . . .

[6] Notice at para. 27 & n.23.

Reconsideration Order, 84 FCC 2d at 66. We concluded that this phased approach to deregulation was necessary to prevent any postponement of "the progress towards a more competitive equipment environment and the promise of a more efficient and reasonably priced service . . . ." *Id.* at 67.

4. We supported our decision by arguing that "a bifurcated approach would avoid potential significant dislocations caused by an abrupt transition; would allow time for a solution to be worked out for any jurisdictional separations problems and would allow steady progress towards a more competitive environment." *Further Reconsideration Order*, 88 FCC 2d at 518–19. Since our issuance of the *Further Reconsideration Order*, we have acted to resolve these jurisdictional separations problems.[7] Among the primary purposes of this proceeding is fashioning a transition plan which prevents dislocations to consumers and the industry and furthers the development of competition. We also note, in retrospect, that competition in fact has continued to flourish in the CPE marketplace since our decision to postpone deregulation of the embedded base.[8] In further explaining the advisability of resolving embedded CPE issues in a separate implementation proceeding, we noted that a meaningful record regarding valuation of the embedded CPE base must be developed because of the substantial size of the embedded base and the risk that inaccurate valuation could produce inequitable results. *Id.* at 521. We justified the need for a separate implementation proceeding by noting that "AT&T has in excess of $10 billion of CPE currently subject to public utility regulation. We could not authorize such a large transfer to the [AT&T] separate subsidiary without first examining the timing, extent and terms of the transfer, and its effect upon competition in the equipment marketplace." *Id.* at 524; *see Notice* at paras. 2–3.

5. As we embarked upon this implementation proceeding in

[7] *See* Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Dkt. No. 80–286, Decision and Order, 89 FCC 2d 1, *modified*, 90 FCC 2d 52 (1982), *appeal docketed sub nom.* MCI Telecom. Corp. v. FCC, No. 82–1237 (D.C. Cir. Mar. 4, 1982).

[8] *See* Notice at para. 27 & n.24. There currently are more than 300 manufacturers of telephone sets and more than 80 manufacturers of PBXs and key systems. AT&T Direct Comments at 2–3. Telephone products are available for purchase at more than 29,000 retail outlets throughout the Nation. *Id.* at 3 n.*. The United States District Court for the District of Columbia (hereinafter District Court) also has acknowledged the competitive nature of the CPE market. United States v. American Tel. & Tel. Co., 552 F.Supp. 131, 192 n.249 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 103 S. Ct. 1240 (1983) (hereinafter United States v. AT&T). The District Court also has found that competition will be enhanced by the retail marketing of CPE by the Bell Operating Companies (BOCs): "The Operating Companies, with their existing relationship to telephone users, are more likely than any other competitive entity to provide an effective counter-balance to AT&T's market strength and thereby to promote a genuinely competitive market." *Id.* at 192 (footnote omitted).

accordance with the approach adopted in *Second Computer Inquiry*, our task was complicated by developments in the antitrust litigation brought by the Department of Justice (DOJ) against AT&T. On January 8, 1982, DOJ and AT&T filed in the United States District Court for the District of New Jersey a proposed modification of the final judgment entered in *United States* v. *Western Electric*, Civil Action No. 17–49 (1956). The action subsequently was transferred to the United States District Court for the District of Columbia and was consolidated with the antitrust litigation pending before the District Court. After conducting procedures under the Antitrust Procedures and Penalties Act, 15 U.S.C. §§ 16(b)-(h) (commonly referred to as the Tunney Act), the District Court approved a Modification of Final Judgment (MFJ) in the proceeding. *United States* v. *American Telephone & Telegraph Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland* v. *United States*, 103 S.Ct. 1240 (1983). With regard to CPE, the MFJ requires that embedded CPE owned by the BOCs together with assets and personnel utilized for the installation and maintenance of the embedded base, must be transferred to AT&T at the time of divestiture. *See id.* at 192 & n.248.[9] Further, the MFJ permits the BOCs "to provide, but not manufacture, [new] customer premises equipment." *Id.* at 231. AT&T, in response to a requirement imposed by the District Court, subsequently submitted to the District Court a detailed proposed plan for reorganizing the Bell System in accordance with the terms of the MFJ. AT&T Plan of Reorganization, *United States* v. *AT&T* (filed Dec. 16, 1982). The

[9] Certain types of embedded equipment will not be transferred to AT&T, but rather will remain with the BOCs after divestiture. These include 911 Public Safety Answering Point CPE, concentrator-identifier systems associated with telephone answering service systems, network channel terminating equipment (such as terminating sets, subscriber pair gain equipment, and repeaters), public and semi-public telephones and extensions, 101 ESS switches used in providing Centrex-CU service, Centrex-CO attendant position equipment (including Centrex consoles and console cabinets), CPE located at Public Service Answering Points used in connection with 911 emergency service, and 60-type console control cabinets and mini-computers associated with ESS-ACD (Automatic Call Distributer) service. *See* AT&T Plan of Reorganization at 82–86, United States v. AT&T (filed Dec. 16, 1982). Since we are primarily concerned in this Order with the resolution of issues relating to embedded CPE owned by AT&T or transferred to AT&T as a result of divestiture, embedded CPE retained by the BOCs will not be detariffed at this time. We will address this issue in a later proceeding in this docket which also will address embedded CPE owned by the Independents and the record carriers. See Part XI.C., *infra*. We note that we have acted to require the BOCs to establish separate organizational structures for the retail marketing of new CPE. Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services, CC Dkt. No. 83–115, Report and Order, FCC 83–552 (adopted Nov. 23, 1983). If any of the BOCs wish to request the detariffing of their embedded CPE so that this CPE can be transferred to their newly created organizational units, we would be willing to address these requests on a case-by-case basis prior to our comprehensive resolution of these issues in a later proceeding in this docket.

Plan contained extensive proposals for the transfer of embedded CPE to AT&T. *Id.* at 78–109. AT&T's proposals regarding disposition of the embedded base were subsequently approved by the District Court. Opinion, *United States* v. *AT&T* (filed July 8, 1983).

6. The action taken by the District Court regarding embedded CPE has complicated our tasks in this proceeding because it removes embedded CPE from the ownership of the BOCs. The divestiture of the BOCs from the Bell System, and the transfer of the embedded base to AT&T, raises the prospect that significant and unnecessary costs will be incurred if detariffing issues addressed in this proceeding were to remain unresolved:

> We . . . must not lose sight of the fact that, because of the timetable of divestiture, there is the potential that AT&T (and, as a consequence, its ratepayers) may be forced to incur costs associated with maintaining the embedded base if detariffing and transfer to [ATTIS] are delayed. We consider it to be our responsibility to seek the avoidance of these costs if we can do so through devising a transitional plan which also promotes our pro-competitive goals while minimizing dislocations and other costs.

Notice at para. 84. We thus have recognized that the industry, as well as ratepayers, consumers, and stockholders, will be well served by timely resolution of the issues confronting us. A primary objective of this *Order* is the fashioning of clear and workable rules and procedures to carry out detariffing so that the present uncertainty surrounding divestiture and its aftermath can be mitigated.

B. *Notice of Inquiry*

7. We indicated in *Second Computer Inquiry* that the purpose of the implementation proceeding would be to address capital recovery and asset valuation issues, alternative procedures for effecting the transition to an unregulated CPE marketplace, and the timing for the removal of embedded CPE from carriers' rate bases. *Reconsideration Order*, 84 FCC 2d at 69. In the *Notice of Inquiry*, we sought comment on four options for detariffing embedded CPE: (1) Sell embedded CPE to inplace customers. (2) Transfer embedded CPE to unregulated service (or, in the case of AT&T, sell this CPE to a separate subsidiary). (3) Sell the embedded CPE to a third party. (4) Allow the embedded base to remain in tariffed service until it is fully retired. *Id.* at 696–97. The second issue addressed in the *Notice of Inquiry* was the problem of the development of rules for valuation of the embedded base. We recognized that "[i]f remaining embedded CPE is to be sold or transferred, it will be necessary to develop procedures for the valuation of such CPE." *Id.* at 697. We adopted the view that the issue of valuation involves two separate analyses. First, it is necessary to define a value standard under which prices for sale and transfer can be determined. Second, a means of measuring value in accordance with the value standard must be developed. We tentatively selected economic value as the appropri-

ate value standard, and defind this to mean "the maximum amount the carrier would be willing to pay for . . . equipment [the carrier owns] if, instead of owning it, the carrier had the opportunity to buy it." *Id.*[10]

8. We also recognized in the *Notice of Inquiry* that it might not be possible to measure the economic value of the embedded base in any real sense, and that "the economic value to be determined is likely to be little more than hypothetical." *Id.* at 698.[11] Because of this problem of measuring economic value, we proposed four alternative methods for establishing a surrogate for economic value: (1) Imitate the capital budgeting process of a firm by estimating future net revenues from the CPE and discounting these revenue flows to the present.[12] (2) Use net book value of the CPE. (3) Appraise the CPE. (4) Conduct auctions for the sale of the CPE. *Id.* We stressed the importance of selecting a workable means of measuring economic value, pointing out that the "amounts involved are enormous, and there could be a substantial adverse impact upon monopoly ratepayers as a result of any underpayment of the regulated entity." *Id.* at 699. The *Notice of Inquiry* also raised accounting issues associated with removal of embedded CPE from tariffed service. First, we pointed out that a costing methodology and accounting procedures

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[10] We noted that the discounted expected flow of net revenues which would be earned from the CPE would indicate the maximum amount the carrier would pay to acquire the CPE. Notice of Inquiry, 89 FCC 2d at 697. We tentatively rejected the use of opportunity cost as a means of defining economic value. Under this approach, economic value would equal the amount the carrier could obtain for the CPE by selling it to another firm. We viewed this approach as deficient because:

> [I]t seems likely that the value of the CPE to the carrier itself would greatly exceed the value to other firms, so that a transfer at opportunity cost would allow the carrier more than full capital recovery. That is, the carrier would continue to earn the allowed rate of return and recover depreciation expenses on the amount of the difference between the economic values calculated by the two approaches, and also achieve an internal rate of return on the assets greatly in excess of the appropriate discount rate.

Id. at 697–98.

[11] Our reason for this conclusion was the fact that the transfer of embedded CPE to detariffed service is a unique event which will take place in the absence of any workable market for the sale of large quantities of embedded CPE. Notice of Inquiry, 89 FCC 2d at 698.

[12] We saw two problems with this method. First, it would be difficult to estimate future net revenues from the embedded CPE base. Second, it would be difficult to adjust these estimates to take into account the uncertainty of the future revenues. We did take note of the fact that:

> [T]he carriers themselves will be performing these calculations internally; so that one possibility is to have the carriers report these results to the Commission. We could then review these studies and either accept the findings as providing measures of economic value or reject them if found to be seriously flawed.

Notice of Inquiry, 89 FCC 2d at 698.

would have to be developed for allocating costs between tariffed activities and activities relating to the detariffed embedded CPE base. *Id.* at 701. Second, we noted that accounting procedures would be necessary "to account for the sale of embedded CPE . . . ." *Id.* at 702. These procedures would be necessary to account for any gains or shortfalls resulting from the sales.

9. Parties filed comments and replies regarding the *Notice of Inquiry* during a pleading cycle which ended July 9, 1982. These comments and replies were summarized in the *Notice* at Appendix A.

C. *Supplementary Filings by AT&T*

10. The changed circumstances resulting from the entry of the MFJ in *United States* v. *AT&T* [13] led AT&T to file Supplementary Comments in this proceeding on October 28, 1982. These Supplementary Comments contained comprehensive proposals for the detariffing and transfer of AT&T's embedded CPE base. As we indicated in the *Notice*,[14] AT&T's Supplementary Comments contained three major elements. First, AT&T proposed that embedded CPE would be transferred to ATTIS at adjusted net book value. Second, the proposal specified that ATTIS would offer this CPE for sale or lease on a detariffed basis. Third, AT&T proposed a "price predictability program" in order to stabilize lease and sale prices for single-line and multi-line CPE during a transition period after detariffing. The AT&T Supplementary Comments proposed that detariffing would begin in July 1983 and be completed by the end of 1983, that AT&T would announce price predictability plans not later than three months after release of an order by the Commission adopting the AT&T proposals, that residential CPE price increases would be limited to percentage increases in the Consumer Price Index (CPI), and that maximum single-line CPE lease rates would be established. *Notice* at para. 9. With respect to multi-line CPE, the AT&T Supplementary Comments proposed that an 18-month price freeze would be established, that outstanding contractual obligations would be honored, that national lease prices would be established, that in-place multi-line equipment would receive maintenance and support from ATTIS, that there would be prior notice of product phase-outs, and that in-place multi-line CPE of a type also sold new by ATTIS would be offered for sale at the end of the 18-month price predictability period. *Id.* at para. 10.

11. Interested parties were given an opportunity to comment on the AT&T proposal. *See id.* at para. 7 n.8. AT&T made several modifications to its proposed detariffing plan in its Reply Comments, which were filed on December 3, 1982. It provided that lease prices

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[13] See paras. 5–6, *supra*, for a discussion of the relationship between this proceeding and the MFJ.

[14] See Notice at para. 9.

for all single-line, PBX, and key equipment would not exceed the highest tariff price in effect after approval by a state commission, and that one-year advance notice would be sought to be given of any multi-line product phase-outs. *Id.* at para. 11. The Further Supplementary Comments filed by AT&T on March 29, 1983, made further modifications and additions to its proposal. In this filing AT&T indicated that it would conduct a national advertising campaign, beginning in July 1983, to inform residential customers of their options under the AT&T plan, that a sale plan for single-line CPE would continue after detariffing, with prices guaranteed not to exceed specified ceilings for at least two years, that monthly lease rates for residential CPE would be continued at specified levels by ATTIS for at least two years after detariffing, that the purchase option for multi-line CPE would be expanded, that multi-line CPE of a type also sold new by ATTIS would be offered for sale at the time of detariffing, and that supporting assets would be independently appraised for purposes of transfer. *Id.* at para. 12.[15] With respect to multi-line CPE, AT&T included further details and additions in its Further Supplementary Comments. AT&T specified in greater detail the types of multi-line equipment which would be made available for purchase at the time of detariffing,[16] and also indicated that it would attempt to make available for purchase almost all types of electromechanical CPE not later than the end of 1985. AT&T stated that it would base its decision regarding the commencement of sale programs for this equipment upon the following criteria: (1) Sufficient customer interest to justify the costs of undertaking a sale program.[17] (2) Sufficient supply of parts. (3) Depreciation schedules

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[15] AT&T proposed that purchase prices for single-line CPE would not exceed:

	Rotary	*Touch-Tone*
Standard (Desk and Wall)	$ 19.95	$ 41.95
Princess (Desk)	39.95	49.95
Trimline (Desk and Wall)	44.95	54.95

These prices would remain in effect for at least two years after detariffing. Prices for refurbished equipment could be higher. AT&T proposed the following monthly lease rates for residential CPE:

	Rotary	*Touch-Tone*
Standard (Desk and Wall)	$ 1.50	$ 2.85
Princess (Desk)	3.15	4.05
Trimline (Desk and Wall)	3.45	4.60

The standard rotary lease rate would not be increased during the two-year period after detariffing. Rates for other residential equipment could be increased by the percentage increase in the CPI during this two-year period. Notice at paras. 13–14.

[16] *See* Notice at para. 15 & nn. 13–14.

[17] For a description of the factors AT&T proposes to use in estimating the costs of sale programs, see AT&T Further Supplementary Comments, Mar. 29, 1983, at 13–15. These factors are discussed at para. 72, *infra*.

which enable the purchase price to recover capital while also being acceptable to customers. (4) Workable means of informing customers regarding the purchase option. *Id.* at para. 15.

II. OVERVIEW OF ISSUES AND PROPOSALS

A. *Notice of Proposed Rulemaking*

12. In the *Notice*, which was released on June 21, 1983, we presented our tentative conclusions regarding the manner in which the embedded CPE base should be detariffed and transferred to unregulated service. After summarizing AT&T's proposals for this detariffing and transfer,[18] we addressed general options which could be pursued in implementing *Second Computer Inquiry* principles in this proceeding and discussed specific issues which must be resolved by the proceeding.

13. With regard to the detariffing options outlined in the *Notice of Inquiry*,[19] we expressed the tentative view in the *Notice* that the most effective means for deregulating embedded CPE would be to require carriers to make in-place CPE available for purchase by current customers and to transfer the unsold portion of the embedded base to the carriers' unregulated service or, in the case of AT&T, to ATTIS. *Notice* at para. 18. We noted that this approach would increase the choices available to consumers and would satisfy our obligations under judicial precedents.[20] We tentatively rejected sale of embedded CPE to a third party as a viable deregulatory option because the size of the embedded base makes this approach impractical and valuation problems still would have to be confronted. *Id.* at para. 21. We also tentatively rejected continued rate regulation as an appropriate transitional device, although we noted that there might be certain circumstances in which continued state tariffing would be a useful mechanism. *Id.* at paras. 22–24. We indicated in the *Notice* that our tentative preference to permit transfer to ATTIS of the unsold portion of the embedded base was contingent upon two factors. First, the portion of the embedded base which is offered for sale must be sufficient to satisfy our regulatory concerns and objectives. Second, we pointed out that our resolution of detariffing issues would depend upon satisfactory resolution of a number of related problems, including valuation of the unsold base,

[18] Notice at paras. 8–16.

[19] See para. 7, *supra*, for a discussion of the options presented in the Notice of Inquiry.

[20] The principal rules regarding the treatment of any gains or losses in connection with the removal of utility assets from regulated service are expressed in Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied sub nom.* D.C. Transit Sys. v. Democratic Cent. Comm., 415 U.S. 935 (1974) (hereinafter, together with companion cases, referred to as Democratic Central Committee). For a description of companion cases, see para. 56 n.48, *infra*.

pricing, duration and terms of the purchase option, and other matters. *Id.* at para. 25.

14. We tentatively concluded in the *Notice* that case law requires that investors receive their net investment at the time CPE is removed from regulated service, with any gains or losses accruing to ratepayers. *Id.* at para. 29. We also tentatively concluded that, with regard to the issue of valuing the embedded base, net book value should be used as a surrogate for economic value. We pointed out, however, that the use of net book value could enable carriers to capture gains by selling transferred equipment for amounts exceeding net book value. To prevent this capture, which might violate the equity principles of *Democratic Central Committee*, we proposed that embedded CPE should be offered for sale to in-place customers at net book value plus reasonable transaction costs, thus enabling these customers to capture any gains in the value of the equipment. We expressed the tentative view that the requirements of *Democratic Central Committee* would be satisfied if all classes of CPE are offered for sale, in the aggregate, at net book value plus reasonable transaction costs, although we noted that it "might be particularly necessary" to apply the net book value test on a disaggregated basis (that is, on the basis of particular CPE product lines rather than on the basis of the embedded base as a whole) "if any significant portions of the embedded base were not offered for sale to subscribers because the undervaluation of any such portion could result in a gain to the transferee entity rather than to the ratepayers." *Id.* at para. 32.

15. We made clear in the *Notice* our view that a sale plan on the part of AT&T would satisfy our regulatory concerns if a "significant portion" of the embedded base were offered for sale before detariffing "or shortly after it is detariffed." *Id.* at para. 33. We tentatively concluded in the *Notice* that AT&T's pricing proposals for single-line and multi-line CPE had diminished the likelihood that ATTIS could engage in anticompetitive pricing policies after detariffing, but we invited parties to comment regarding whether any additional pricing requirements are necessary. With regard to the duration of the transition period[21] following detariffing, we tentatively concluded that proposals to extend the periods proposed by AT&T should not be adopted. *Id.* at para. 38.[22] We also expressed the tentative view that

[21] In its comments, AT&T has characterized the period during which pricing guarantees and other assurances would be in effect after detariffing as the "price predictability period." We intend our references to the "transition period" to be synonymous with AT&T's characterization.

[22] AT&T's proposed price predictability period is two years for single-line equipment and 18 months for multi-line equipment. Notice at para. 38 n.33. AT&T also has noted that, under its plan, the price predictability period for multi-line equipment not offered for sale by July 1, 1985, will be extended to the end of 1985. AT&T Reply Comments at 17 n.*.

multi-line customers should not be disadvantaged by the fact that the transition period proposed by AT&T for multi-line equipment is six months shorter than the transition period for single-line equipment, but we sought comments on this issue. *Id.* at para. 39. We tentatively concluded that use of CPI as a reference for adjusting prices during the transition period did not appear to be an unreasonable method for accounting for increases in the cost of doing business during this period. *Id.* at para. 40.

16. We sought comments in the *Notice* regarding the notice which ATTIS should be required to give in connection with any discontinuance of product maintenance and regarding the adequacy of warranty periods proposed by AT&T. *Id.* at para. 41.[23] We also expressed the preliminary view that ATTIS should be permitted to assess interest charges in connection with installment purchases of embedded equipment. *Id.* at para. 42. We expressed tentative general support for the proposal that the BOCs be authorized to provide billing and other support services to ATTIS on an interim basis after transfer of embedded equipment to ATTIS. We invited comment regarding the manner in which the BOCs should be compensated for these services. With regard to BOC customer proprietary information to which ATTIS may have access in connection with the provision of billing and other support services to ATTIS by the BOCs, we sought comment regarding whether any disclosure of such information to ATTIS should trigger automatic disclosure to competing vendors, or whether such disclosures to other vendors should be within the discretion of the customer involved. *Id.* at paras. 43–49. The *Notice* requested parties to comment on the issue of whether the proposed pricing structure might be construed as impermissible under the antitrust laws. *Id.* at para. 50.

17. The *Notice* addressed a number of tax and accounting issues associated with detariffing. We tentatively concluded that our determination of the proper accounting treatment for deferred income taxes, unamortized investment tax credits, and Western Electric deferred taxes should be treated separately from the valuation of the embedded CPE base. With regard to deferred taxes, we tentatively embraced AT&T's proposal that the transfer price of embedded CPE should be reduced by the amount of deferred taxes. The *Notice* tentatively found that unamortized investment tax credits should be credited to carriers' income tax expense at the time associated assets are removed from regulated service. *Id.* at paras. 52–59. We tentatively concluded in the *Notice* that the rules of the Commission should be revised so that any gains resulting from the transfer of land to ATTIS would be treated in a manner which

[23] AT&T has proposed a warranty period of 90 days for inventory purchases and 30 days for in-place purchases. Notice at para. 41. *But see* para. 82, *infra* (AT&T's proposals regarding warranty periods not clear).

benefits AT&T's ratepayers, and we proposed accounting changes to achieve this result. We tentatively concluded further that appraisal costs should be divided between the BOCs and ATTIS. *Id.* at paras. 60–62. We solicited comment in the *Notice* regarding the proper accounting treatment for embedded CPE sales currently being conducted by the BOCs and Independent telephone companies under state tariffs. *Id.* at paras. 63–64.

18. We raised several additional issues in the *Notice.* We sought comment, for example, regarding whether intrasystem wiring should be treated as part of associated multi-line CPE and transferred to unregulated service together with the CPE. *Id.* at paras. 69–70. With regard to Independent telephone companies, we recognized in the *Notice* that the schedule for detariffing embedded CPE owned by the Independent companies does not need to be the same as that applicable to AT&T because the MFJ has caused timing concerns unique to AT&T. We tentatively concluded that embedded CPE owned by the Independents should be detariffed not later than the end of 1987. In this regard, it was our tentative view that the states should be given considerable discretion in providing for the deregulation of embedded CPE owned by Independent companies in their respective jurisdictions. We proposed that we would exercise our preemptive power to establish detariffing rules for the Independents in those states which fail to establish detariffing plans by July 1, 1985. *Id.* at paras. 71–74. Further, we proposed that accounting procedures proposed for record carriers in *USOA Amendments*, CC Docket No. 82–678[24] should be applied to the Independents regarding their activities associated with the embedded CPE base. *Id.* at paras. 65–68. Finally, we tentatively proposed that embedded CPE owned by Western Union or the international record carriers (IRCs) should be detariffed by the end of 1987, that the record carriers must submit detariffing plans to the Commission not later than June 30, 1984, that the Commission will apply general guidelines to protect the interests of both ratepayers and investors in reviewing these plans, that the principles adopted in this proceeding for the detariffing of embedded CPE owned by AT&T or the Independents also would apply to Western Union and the IRCs, and that the accounting procedures ultimately adopted in *USOA Amendments* would apply to

[24] Since the issuance of the Notice, these accounting procedures have been adopted by the Commission. Amendment of Part 34, Uniform System of Accounts for Radio-telegraph Carriers, and Part 35, Uniform System of Accounts for Wire-Telegraph and Ocean-Cable Carriers of the Commission's Rules and Regulations and Conforming Amendments to Annual Financial Reports Form O for Wire-Telegraph and Ocean-Cable Carriers and Form R for Radiotelegraph Carriers with Respect to Accounting for Customer-Premises Equipment after Detariffing, CC Dkt. No. 82–678, Report and Order, FCC 83–398, 48 Fed. Reg. 45078 (released Sept. 21, 1983) (hereinafter USOA Amendments).

embedded CPE offerings of Western Union and the IRCs after detariffing. *Id.* at paras. 75–79.

19. Numerous parties filed comments and replies regarding the *Notice* during a pleading cycle which ended August 22, 1983. A list of these parties is included as Appendix C of this *Order*. Summaries of these comments are included in the docket of this proceeding as appendices of this *Order*.

B. *Bureau Letter of Inquiry to AT&T*

20. The Chief, Common Carrier Bureau, in a letter to AT&T dated September 16, 1983, focused attention on a number of issues in this proceeding. Letter from Chief, Common Carrier Bureau, to William A. Davis II, Attorney for AT&T (Sept. 16, 1983) (hereinafter Bureau Letter). The Bureau Letter noted that, "[u]pon review of the AT&T proposal, [the Bureau has] determined that the provision of certain additional information is necessary in order to assist the Commission in rendering a decision in this proceeding." *Id.* The letter was designed to facilitate a more complete analysis of AT&T's proposed plan and to elicit responses to comments by parties to the proceeding. The questions addressed issues relating to the proposed sale and lease program, the treatment of taxes, and various other matters.[25]

III. SUMMARY OF DECISION

21. The decisions and conclusions we have reached in this *Order* may be broadly summarized as follows:

(1) We find that we have ample statutory authority to impose requirements upon AT&T in connection with the detariffing of the embedded CPE base and its transfer to ATTIS. We conclude that our statutory powers will enable us to monitor AT&T's compliance with our requirements and to take any necessary remedial action in the event of any non-compliance.

(2) We conclude that a sale plan for embedded CPE, together with transfer of the embedded base to unregulated service, will form the basis for the detariffing plan we establish in this *Order*, because this approach is the best means for achieving a transition to a completely deregulated CPE marketplace.

(3) We require that net book value of AT&T's embedded base will be used as a surrogate for economic value for purposes of establishing sale prices for the transition period and valuing the equipment to be transferred to ATTIS.

(4) We conclude that, for purposes of valuation and the establishment of sale prices, AT&T shall be required to disaggregate the embedded base on the basis of single-line and multi-line equipment. We find that no further disaggregation is necessary to achieve our objectives in this proceeding.

(5) We conclude that our detariffing and transfer plan is fully consistent with the equitable principles set forth in *Democratic Central Committee*. We find that

[25] For a presentation of questions contained in the Bureau Letter, together with a summary of AT&T's responses and the comments of interested parties, see Appendix D, which is included in the record of this docket.

our plan properly accommodates the interests of both ratepayers and investors, provides for a workable means for removing CPE assets from regulated service under the extraordinary circumstances confronting us as a result of the divestiture of the Bell System, and protects the viability and efficiency of the national telecommunications system.

(6) We accept AT&T's proposed sale and lease program for residence and business single-line CPE, finding that the proposal is consistent with our objectives in this proceeding. AT&T will be required to comply with this program.

(7) We permit the entire multi-line base to be detariffed and transferred to ATTIS at divestiture. We provide, however, that the transition period applicable to the various product lines of multi-line CPE will begin to run at the time the product lines are first offered for sale by ATTIS, rather than on the date of divestiture, and that the transition period shall have a duration of two years from the initial date of the sale offering.

(8) We require that, if a multi-line CPE product line is not offered for sale at the time of divestiture, then lease customers will continue to pay lease rates which are equivalent to the applicable state tariff lease rates in effect at the end of 1983 (if these state tariff lease rates are less than AT&T's announced initial minimum lease rates for the product line involved). AT&T's national lease rates will not apply to these product lines until the product lines are initially offered for sale by ATTIS.

(9) The national lease rates which ATTIS may establish for equipment of a type which is not also leased as new equipment by ATTIS are capped at the higher of an amount equal to 70 percent of the highest state tariff in effect for the product line involved on March 29, 1983, and the statistical median of all state tariffs for such product line on such date. AT&T will be required to comply with this ceiling.

(10) We permit the BOCs to provide billing and other support services to ATTIS on a compensatory basis. We permit ATTIS to have access to CPE customer-specific information, but require that access to non-CPE service information must be restricted and that ATTIS must inform its embedded CPE customers that they may obtain information regarding their CPE from ATTIS. Further, we find that there is no basis for requiring ATTIS to compensate the BOCs for the transferred customer information.

(11) We provide that, if ATTIS decides to phase out maintenance and support of particular line products during the transition period, it must provide one year's notice (in most cases) and must make available rights necessary for the support of the phased-out product.

(12) We require that deferred tax reserves and unamortized investment tax credits associated with the embedded base must be transferred to ATTIS. We also authorize AT&T to carry out the restoral of deferred taxes on Western Electric profits in the manner proposed by AT&T in this proceeding.

(13) We require land and buildings to be transferred to ATTIS at appraised value, while other supporting assets must be transferred at net book value. We provide that the BOCs must pay the appraisal costs.

(14) Regarding the current sale of embedded CPE under state-approved programs, we find that current accounting rules, which treat proceeds from sales as gross salvage and transaction costs as cost of removal, are appropriate and do not need to be altered.

(15) We conclude that intrasystem wiring currently owned by AT&T or the

Independent telephone companies will not be detariffed and removed from regulated service. With respect to AT&T, we do not require any transfer of intrasystem wiring from the BOCs to ATTIS.

(16) We find that CPE station handling costs in account 232, "Inside wiring," shall not be added to net book value upon removal of the embedded CPE base from regulated service.

(17) We require that certain CPE associated with national security and emergency preparedness communications systems shall be detariffed and transferred to ATTIS. We provide, however, that this requirement shall not take effect until June 1, 1984, so that parties may have an opportunity to petition the Commission for a waiver and the Commission may have an opportunity to conduct a more extensive inquiry into these issues.

(18) We approve AT&T's proposed treatment of debt in its embedded base capitalization plan for ATTIS, and we find that the capitalization plan will not directly cause any increase in AT&T's overall financing needs.

(19) We provide that decisions with respect to the deregulation of embedded CPE owned by the Independent telephone companies or by the record carriers will be taken in a subsequent action in this docket.

IV. SCOPE OF COMMISSION AUTHORITY

22. AT&T argues in its Comments responding to the *Notice of Inquiry* that, because the Commission has not been explicitly empowered by statute to require the sale of embedded CPE, the Commission lacks authority to alter the sale program that AT&T voluntarily proposes. AT&T Comments of June 6, 1982, at 21–22 and Appendix A. AT&T further argues that even if the Commission had such statutory authority, and order that AT&T must sell embedded CPE would violate the Fifth Amendment of the United States Constitution.[26] No parties support AT&T's position, and the July 9, 1982 comments of Ad Hoc, IDCMA and UTCC oppose AT&T's view. We find that the Communications Act of 1934, provides ample authority to require the detariffing of embedded CPE and to impose reasonable conditions on the manner of such detariffing. As explained in the succeeding Parts of this *Order*, CPE should be detariffed subject to certain transitional conditions. These conditions, which include inplace sale of embedded CPE, are reasonable. In light of this, we conclude that the requirements of this *Order* are lawful. Our reasoning follows.

23. The Act gives the Commission authority to regulate all "inter-state and foreign commerce in communications by wire and radio," including "all instrumentalities, facilities, apparatus, and services . . . incidental [thereto]." Sections 2, 3(a), 3(b), and 3(f) of the Act, 47 U.S.C. §§ 152, 153(a), 153(b), 153(f). The Act empowers the

[26] The Fifth Amendment provides that:

> No person shall . . . be deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Commission to use this authority to make available "rapid, efficient, nation-wide, and world-wide wire and radio communications service." Section 1 of the Act, 47 U.S.C. § 151. With this broad grant of authority, Congress intended "to endow the Commission with sufficiently elastic powers such that it could rapidly accommodate dynamic new developments in the field of communications." *General Telephone Co. of the Southwest* v. *FCC*, 449 F.2d 846, 853 (5th Cir. 1971). *See also FCC* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 138 (1940). Congress gave the Commission "a comprehensive mandate" with "expansive powers." *National Broadcasting Co.* v. *United States*, 319 U.S. 190, 219 (1973).

24. In our *Second Computer Inquiry* decisions, we found that the provision of CPE is severable from common carrier communications services and, as such, should be excluded from Title II tariff regulation. Nevertheless, we have authority over a carrier's provision of untariffed CPE to the extent necessary to protect the public interest. This is based on Section 2(a) of the Act, 47 U.S.C. § 152(a), which permits us to assert jurisdiction over a carrier's activities which are not within the reach of Title II. *See United States* v. *Southwestern Cable Co.* 392 U.S. 157, 172 (1968). Such jurisdiction is limited to that which is "reasonably ancillary to the effective performance of the Commission's various responsibilities." *Id.* at 178. Among these responsibilities is the need to assure a nationwide system of wire communications services at reasonable prices. Section 2 of the Act, 47 U.S.C. § 152. Because carriers' bundling of CPE charges into transmission rates has a direct effect upon rates for interstate transmission services, it is reasonable to assert jurisdiction over carrier provision of CPE in order to carry out our duty to assure the availability of transmission services at reasonable rates. Accordingly, our jurisdiction over carrier-provided CPE is "reasonably ancillary" under *Southwestern Cable. CCIA* v. *FCC*, 693 F.2d at 213.

25. In this proceeding, we seek to exercise our ancillary jurisdiction over CPE in a manner which will promote two interests. The first is embodied in the principles of *Democratic Central Committee*, and the second is stated by *CCIA* v. *FCC*. As to the first, we seek to protect the ratepayers' equitable interest in capturing gain on assets removed from regulated service. For the reasons stated generally in Part V, *infra*, the sale program prescribed today in this *Order* is a reasonable means of securing that end. The second interest which we seek to protect with the detariffing conditions prescribed in this *Order* is our obligation to assure that CPE will be available to users at reasonable prices. That obligation arises in the following manner.

26. The Court of Appeals' opinion in *CCIA v. FCC* established beyond doubt that we may regulate the carrier provision of CPE by unbundling and detariffing CPE charges. *Id.* at 209. Although *CCIA v. FCC* upheld our authority to detariff CPE, that decision made

clear that the Commission does not have unfettered discretion to regulate or not regulate a common carrier's services. The court observed that "[t]his is not a case in which the Commission has attempted to end Title II regulation without substituting other regulatory tools." *Id.* at 212. The alternative regulatory tool on which *Second Computer Inquiry* relies is the constraint of an "increasingly competitive market which indicates that CPE will be available at reasonable rates." *Id.* at 211. Thus, while the Commission may detariff embedded CPE, we have a regulatory interest in assuring that this does not interrupt the availability of CPE at reasonable rates.

27. AT&T argues that a sale program which is imposed upon AT&T results in deprivation of AT&T's substantial use and enjoyment of its property. This, according to AT&T, constitutes a "taking" for which the Fifth Amendment requires just compensation. AT&T seeks to extend the Constitution's words beyond their accepted meaning. The law is well established that if a regulation bears a reasonable relationship to a legitimate state end, it is not a "taking."[27] The ends promoted by this decision are protection of the ratepayer's equitable share of the gains on regulated assets and the public's interest in the availability of reasonably priced CPE. As stated above, the transition program's conditions prescribed by this *Order* are reasonable means to achieving these legitimate ends.

28. Without doubt, many forms of regulation limit the property owner's power to extract value from the property. To that extent, regulation deprives owners to some degree of the use and enjoyment of their assets. However, "the decisions . . . uniformly reflect the proposition that diminution in property value standing alone, cannot establish a 'taking' . . . ." *Pennsylvania Central Transportation Co.* v. *New York City*, 438 U.S. 104, 131 (1978).[28] Indeed, this Commission's reasoned regulations lawfully can impose a substantial burden on an asset's value. For example, Commission rules have resulted in the diverstiture of community antenna television (CATV) systems owned by telephone companies. In 1970 the Commission effectuated rules prohibiting telephone common carriers from engaging in the furnishing of CATV service to the public in their telephone service area. *See* Section 64.601 of the Commission's Rules, 47 C.F.R. § 64.601. On appeal, petitioners argued that the rules unjustifiably required the

[27] *See* Moore v. City of East Cleveland, 431 U.S. 494, 499–500 (1977); Goldblatt v. Town of Hempstead, 369 U.S. 590, 594–95 (1962); *cf:fo. Prune Yard Shopping Center v. Robins, 447 U.S. 74, 85 (1980) ("The law shall not be unreasonable, arbitrary or capricious and . . . the means selected shall have a real and substantial relation to the object sought to be attained.").*

[28] *See also* Village of Euclid v. Ambler Reality Co., 272 U.S. 365, 384 (1962) (75 percent loss of economic use); Hadacheck v. Sebastion, 239 U.S. 394, 405 (1915) (over 90 percent loss); Consolidated Rock Products Co. v. City of Los Angeles, 57 Cal. 2d 515, 517–19, 370 F.2d 342, 344, 20 Cal. Rptr. 638, 640, *appeal dismissed*, 371 U.S. 36 (1962) (regulation deprived land of all economic use).

telephone companies to dispose of systems acquired prior to promulgation of the rules. *General Telephone Company of the Southwest* v. *United States*, 449 F.2d 846, 863 (5th Cir. 1971). Upholding the rules as reasonable, the court stated that "[t]he property of regulated industries is held subject to such limitations as may reasonably be imposed upon it in the public interest and the courts have frequently recognized that new rules may abolish or modify pre-existing interest." *Id.* at 864. The purpose of the CATV rules was to prevent extension without justification of the carriers' monopoly position to broadband cable services. *Id.* at 851. Similarly, a purpose of *Second Computer Inquiry* is to terminate the unnecessary inclusion in regulated monopoly services of a severable commodity. Detariffing of embedded CPE constitutes a reasonable means to that legitimate end.

29. If, for sake of argument, the prescribed detariffing conditions were analyzed as a "taking," the conditions we are imposing, including the sale conditions, nevertheless meet Constitutional standards. The compensation afforded by these conditions is "just." In the absence of any feasible alternative means of identifying fair market value, the grant to AT&T by this *Order* of the power to set sale prices at adjusted net book value plus transaction costs necessarily affords AT&T just compensation.[29] AT&T nevertheless argues that even where just compensation is provided, private property cannot be taken for private use of another. According to this analysis, a sale in place to a customer effects no change in the existing use, and, consequently, no public use has resulted. The detariffing conditions, however, effect a public use not otherwise present. Prior to implementation of a sale program, the property was used by AT&T as a means to generate revenue from which the utility owners could earn a return on their investment. Upon implementation of the prescribed detariffing conditions, the property will also be used as a means to assure that ratepayers are afforded an opportunity to obtain any gain on regulated assets and to assure that AT&T can introduce embedded CPE operations into the detariffed market without impairing that market's growing competitiveness and disrupting the availability of CPE at reasonable prices.

30. With its arguments concerning the constitutionality of the prescribed detariffing conditions, AT&T reveals its doubts about the Commission's ability legally to implement such a program. Our above discussion of the merits of those arguments vigorously seeks to dispel AT&T's doubts. If AT&T is correct, and we are unable to pursue a properly structured detariffing of embedded CPE, we are left with no alternative but to rely on an approach for which we have undoubted authority. The sole such approach which we are able to

[29] *Cf.* Monogahela Navigation Co. v. United States, 448 U.S. 312, 326 (1983) ("the compensation must be a full and perfect equivalent for the property taken").

identify is continued tariffing of the embedded CPE until it is fully depreciated. That alternative is undesirable because it is patently inconsistent with our finding in *Second Computer Inquiry* that it is in the public interest to terminate all tariffing of CPE.[30] To paraphrase the *Notice of Inquiry*, the question is not whether to detariff but how rapidly.

V. GENERAL RULES GOVERNING AT&T EMBEDDED BASE

31. This Part will discuss the general framework we have selected for purposes of detariffing the embedded CPE base of the divested BOCs and providing for its transfer to ATTIS. We will focus on the detariffing options we originally sketched out in the *Notice of Inquiry*, and we will set out the options we have selected, together with an explanation of our reasons for making these selections. We will examine the issue of valuation of the embedded base, again setting out our resolution of the valuation question and the reasons for the approach we are taking. We will include in this analysis our conclusions regarding our responsibilities under *Democratic Central Committee* and the application of its principles to this proceeding. In Parts VI and VII we present a more detailed discussion of our conclusions, and the requirements we are establishing, regarding single-line and multi-line CPE to be transferred to ATTIS.

32. In a 1980 decision, the Commission allowed AT&T to offer new CPE only on an untariffed basis and through a separate subsidiary. The separate subsidiary structure was designed in part to assure that AT&T participated in the new CPE market on an equal footing with other competitors. These restrictions on AT&T's activities were extensive and stringent.[31] Based on our assessment of the

[30] For that reason we reject a suggestion raised by a commenter. IDCMA suggested in its June 6, 1982, comments that questions about the power of the Commission to require a sale program can be avoided if they are simply presented as conditions on AT&T's permissive detariffing of its embedded base. Such an approach would raise the risk that AT&T, for its own reasons, would find continued tariffing advantageous and, as a result, delay advancement of the public interest in removing all CPE from tariff regulation.

Further, even if some form of regulation under title II of the Act were justifiable, we still could require sale of CPE at just and reasonable "charges." Nowhere in the provisions of Sections 201–205 of the Act is there a requirement that regulation be limited to lease "charges." Our prescriptive authority under Section 205(a) of the Act extends to "any charge, classification, regulation, or practice" and clearly includes sale and lease charges alike.

[31] The subsidiary must have its own books, separate officers, its own operation, marketing, installation, and maintenance personnel, and must use separate computer facilities for the provision of enhanced service. Section 64.702 of the Commission's Rules, 47 C.F.R. § 64.702. The manner of capitalizing or modifying the capitalization of the subsidiary must be approved by the Commission. *Id.* The subsidiary cannot own transmission facilities. *Id.* AT&T and the subsidiary cannot share space. Final Decision, 77 FCC 2d at 477. AT&T cannot assist the subsidiary in the development of software except for generic software. Section

growth of competition in the CPE marketplace, we found that the imposition of the separate subsidiary conditions on AT&T's provision of untariffed CPE would assure that competition would continue to grow and that CPE would be available to communications users at reasonable rates. That finding, however, was predicated on the "bifurcation" of CPE which permitted AT&T to offer only new CPE on an untariffed basis. *See* paras. 3–4, *supra.*

33. This proceeding's determination of the manner in which embedded CPE should be offered requires us again to examine whether CPE will be available at reasonable rates, consistent with *CCIA v. FCC. See* paras. 25–26, *supra.* We are not bound here by our earlier findings as they pertain to new CPE because the decisional factors here are very much different. Earlier we had to decide whether the availability of CPE at reasonable prices would be disrupted by AT&T's establishment of a new organization which, similar to any other new entrant, would have no share of the market it sought to enter. The requirement that AT&T start as if "new" limited any potential dangers that AT&T's large installed base may have borne for the unregulated market. We now face the very different task of ensuring that elimination of the tariffing constraints over billions of dollars of AT&T's embedded equipment be accomplished in a manner which will not retard the competition which has flourished during the years of the bifurcated regulation of CPE under *Second Computer Inquiry.* We repeat: "AT&T has in excess of $10 billion of CPE currently subject to public utility regulation. We could not authorize such a large transfer to the separate subsidiary without first examining the timing, extent and terms of the transfer and its effect upon competition in the equipment marketplace." *Further Reconsideration Order*, 88 FCC 2d at 524.

34. The experience we have acquired in this area, our examination of the record in this proceeding, and our survey of publicly available information all convey the same message: while AT&T's CPE operations in recent years have been, and for the foreseeable future will be, very much susceptible to competition, AT&T's installed base remains so great that it is difficult to warrant with

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64.702 of the Commission's Rules, 47 C.F.R. § 64.702. The subsidiary can obtain basic transmission service only under tariff. *Id.* All interactions between the subsidiary and unseparated affiliates must be compensatory and auditable. *Id.* AT&T must publicly disclose with reasonable advance notification any information concerning changes in the network which may affect interconnection of CPE or other carriers. *Id.* Customer proprietary information made available to the subsidiary must be made available to competitors on the same terms and conditions. *Id.* The Commission retained power to examine the operations of the subsidiary, including research and development conducted jointly with unseparated affiliates. Final Decision, 77 FCC 2d at 481. The Commission also retained power to investigate prices charged by the subsidiary. Reconsideration Order, 88 FCC 2d at 109. New restrictions may be imposed where appropriate. *Id.* at 71.

requisite certainty that immediate and total deregulation of embedded CPE would not lead to undesirable disruptions in the availability of CPE to the Nation's users at reasonable prices.[32] Accordingly, this *Order* prescribes a graduated, albeit rapid, transition to total deregulation of AT&T's embedded CPE. We believe those conditions, including the inplace sale requirements, constitute a reasonable means of fostering continued vigorous growth of competition in CPE provisioning and of assuring no disruption of user access to reasonably priced CPE. These conditions cannot be viewed as unduly restrictive means to these ends. The stringent requirements of structural separation have proved to be appropriate conditions on AT&T's start-up of untariffed CPE operations. Perforce, the temporary conditions prescribed by this *Order* are not an undue burden on AT&T's detariffing of its very large existing CPE business. In addition, they constitute a reasonable means of assuring that ratepayers may share equitably in gains incurred upon the removal of assets from regulated service. *See* Part V.C., *infra*. In sum, we find that the conditions to detariffing and transfer prescribed in this *Order* are reasonable means to achieving the proper ends of this Commission.

A. *Detariffing and Transfer Plan*

35. As we have already noted, we had tentatively concluded that a sale plan for embedded CPE, coupled with transfer to unregulated service at net book value of the unsold portion of the embedded base, is the best means for carrying out the transition to a completely deregulated CPE marketplace. *See* para. 13, *supra*. Nothing in the comments has convinced us that we should embark on a different path and, therefore, we have concluded that the sale and transfer options will form the backbone of the detariffing plan we are establishing in this proceeding. Considerable support is evidenced in the comments for the overall approach we tentatively favored in the *Notice*. One commenter, for example, concludes that our proposal is

[32] Our information and judgment indicate that AT&T clearly is the largest single participant in the CPE market. Measured as a share of installed base, AT&T's recent market position has hovered above 50 percent, but may decrease to a share somewhat below 50 percent in the coming years. The strength of AT&T's position varies with the category of CPE: single-line, Key system, small PBX, or large PBX. For example, stated as a share of installed base, AT&T's position in the Key system market is substantially stronger than in the PBX markets. We also observe that AT&T's share for each of these categories of CPE, stated as percentages of recent shipments and of projected shipments, is generally smaller than its percentage share of the installed base of corresponding CPE categories. The unit measure of AT&T's installed base is roughly an order of magnitude larger than that of its shipments. In sum, competitors are making inroads into AT&T's market position. AT&T, however, retains strength by virtue of its large installed base. On the basis of the information available to us, the full potential of that strength, immediately and unconditionally deregulated, is difficult to predict with a reasonable degree of confidence.

the only workable method for carrying out an orderly transition to an unregulated CPE market. Ameritech Direct Comments at 2. Another commenter argues that present circumstances warrant early elimination of tariffed regulation of the embedded base. Illinois Direct Comments at 2. In the view of another commenter, our proposed plan is administratively workable and will prevent any windfall to AT&T stockholders. Wisconsin Direct Comments at 2–3. Several other commenters express their general support for our sale and transfer plan. Ad Hoc Direct Comments at 5; AT&T Reply Comments at 1 (there is a broad consensus among commenters for detariffing the embedded base); CBEMA Direct Comments at 1; Kentucky Direct Comments at 1; Michigan Direct Comments at 1; Minnesota Reply Comments at 2; Tandy Direct Comments at 2.[33]

1. *Advantages of Commission Plan*

36. We briefly discussed in the *Notice* several advantages of a sale and transfer plan as a means of achieving deregulation of the embedded base. *Notice* at paras. 19–20. We here elaborate the advantages of our plan, since they form an important basis for the action we are taking in this *Order*. First, requiring ATTIS to offer single-line and multi-line equipment for sale during the transition period is essential to protect in-place customers from adverse effects associated with removing the embedded base from regulated service. We subsequently will discuss in this *Order* the issues of valuation of the embedded base for purposes of the sale program, and the terms and conditions of sale, but it is important to stress at the outset that our plan, in requiring that reasonable sale offers be extended to all inplace customers, ensures that these customers can make informed judgments from a full set of options as they assess their telecommunications needs in the wake of divestiture and the massive changes in the Bell System. If customers were deprived of the opportunity to purchase their in-place CPE at reasonable prices during the transition period, they could be faced with choosing between paying unreasonable rates to continue leasing their in-place equipment from ATTIS (after the transition ends and ATTIS no longer is committed to maintaining frozen lease rates), or purchasing or leasing other equipment at potentially supracompetitive prices. There is no need for confronting in-place customers with these choices, especially since requiring a purchase option does not work to the detriment of AT&T's stockholders. As we will discuss in later sections of this *Order*, we believe that we have fashioned a sale program which gives customers meaningful choices and thus protects them against dislocations during and after the transition period.

[33] The sale and detariffing option also has received considerable support from commenters at earlier stages of this proceeding. *See* Notice at para. 20 n. 20.

37. Second, we reiterate the view we expressed in the *Notice* that the equitable standards set out in *Democratic Central Committee* can be satisfied, in part, by requiring that the embedded base be offered for sale to current users at reasonable prices. We will discuss our obligations under the case law in detail in later sections, but it is important to note here that the rights and interests of ratepayers cannot be overlooked or diminished as we move toward a deregulated CPE marketplace. Leaving aside for a moment the principles and requirements of applicable case law, we must stress that it has been our policy throughout this proceeding to prevent the sheer enormity of this unprecedented transfer of assets out of regulated service from overwhelming any effort to stand fast in guarding the interests of ratepayers and current users. *See, e.g., Notice* at paras. 19–20, 31–32, and 81–84; *Notice of Inquiry*, 89 FCC 2d at 699.

38. Third, our sale and detariffing plan, on the face of it, achieves the deregulatory goals of *Second Computer Inquiry* and this proceeding. We have long been convinced that the marketplace, and not governmental regulation, should control the activities of carriers in the provision of CPE. Regulation often can distort the workings of the market by imposing costs on market participants which they otherwise would not have to bear. Although regulatory controls are necessary as surrogates for competition in a monopoly environment, the advent and growth of competition in a particular market eliminates the need for continued regulation. Our assessment of the status of competition in the CPE marketplace has led us to conclude that "[t]he problem at this point is no longer where we are going but how to get there." *Notice of Inquiry*, 89 FCC 2d at 695. That is, the growth of competition has provided the need and justification for detariffing. We are now concerned only with arriving at the best means of achieving this result. As the subsequent discussion will make evident, the path toward detariffing is not an easy one and poses many difficult questions which must be resolved. We believe that we have fashioned workable and equitable solutions to these problems, and that we have done so by establishing a detariffing plan which represents the most effective means of forwarding our deregulatory goals.

39. Fourth, we have concluded that the sale and transfer plan which we require in this *Order* is the most propitious means for fostering the continued growth of competition in the CPE marketplace. As we noted in the *Notice*, we have sought to follow a policy of promoting competition in the CPE marketplace and we have seen our efforts rewarded by the development of vigorous competition with attendant benefits to the industry and consumers alike. *Notice* at para. 27 & nn.23–24. In order to continue this movement toward full competition in the CPE market, it is critical to expedite the removal of CPE from regulated service. Regulatory controls have no place in a competitive environment and there is wide consensus in

this proceeding that we should act to remove these controls. On the other hand, however, we must carefully gauge the effects on the continued strength of competition which may be caused by the removal from regulated service of AT&T assets which have been estimated to have a book value in excess of $10 billion. *Notice* at para. 21 n.21. Our concern for these effects will become evident in the following sections. We are confident that competition and its benefits have been augmented by these actions, and that the sale and transfer plan we are establishing in this *Order* fully comports with our statutory responsibilities and our obligation to protect the public interest.

2. *Disadvantages of Other Options*

40. The sale and transfer plan we are establishing in this *Order* constitutes a combination of the first and second options listed at para. 7, *supra*. The other two options involve selling the embedded base to third parties and retaining embedded CPE under state tariff until it is fully depreciated. We tentatively rejected auction-type sales to third parties in the *Notice* because the size of the embedded base makes this approach impractical, and we still would be forced to value the embedded base for purposes of its removal from regulated service. *Notice* at para. 21.[34] There is virtually no support for this approach in the comments.[35] We affirm the rejection of this approach here.

41. Several commenters, however, do suggest varying permutations of continued state tariffing as an appropriate means of effecting a transition to a deregulated CPE marketplace. Although these suggestions come almost exclusively from state commissions (which can be said to maintain a particular interest in the continued exercise of their tariffing authority), there is sufficient interest in this approach in the comments to warrant a review of them here. The states argue that: (1) the unsold embedded base should remain under state tariff, contending that costs to AT&T associated with an embedded base organization (EBO) would not be substantial and maintaining that the embedded base should be kept under state tariff until the end of 1987; (2) any class of CPE which is not offered for sale by AT&T should remain under state tariff; (3) state tariffs should remain in effect if an insufficient portion of the embedded base is offered for sale by AT&T; (4) current state plans for the sale of AT&T's embedded CPE under state tariff should be allowed to

[34] AT&T has indicated that it "is not currently engaged in an effort to arrange for sale of substantial portions of the embedded base to third parties." AT&T Response to Bureau Letter at 41.

[35] One commenter suggests offering the embedded base for sale in lots to third parties. The lot size would be based on statewide sales, sales within a local access and transport area (LATA), or some other measure. North Dakota Direct Comments at 4–5.

continue in place after divestiture; (5) no blanket detariffing of the embedded base should be carried out because AT&T has not come forward with an adequate sale plan which includes the offering for sale of all of the embedded base, and there should be gradual detariffing to be completed by the end of 1987; and (6) a benchmark for embedded sales should be established (75 percent of the embedded base is suggested), and detariffing should not be permitted to begin until this benchmark in sales has been reached.[36]

42. In addition, California suggests an approach which attempts to eliminate the necessity for an EBO while also retaining a degree of state tariffing authority. Under this proposal, the entire embedded base would be transferred to ATTIS at divestiture. During the first year after divestiture, the states would have the option to establish tariffed sale programs for single-line and multi-line CPE. These programs would be established in accordance with Commission guidelines relating to valuation of the embedded base, maintenance and support requirements, and other issues. If a state acted to establish such a program, it would remain in effect until the end of 1986, with the state exercising authority (within the Commission guidelines) to designate sale prices, to establish transaction cost criteria and rules, and to take other action in connection with the sale of the embedded base under tariff. All restrictions regarding the sale of the embedded base by ATTIS would be removed at the end of 1986. If a state chose not to establish its own tariffed sale program, then ATTIS would sell the embedded base during the transition period pursuant to rules established by the Commission. California Direct Comments at 3–4.[37] NATA suggests that a "stand alone" or "autonomous" rate base should be established for embedded CPE, and that this rate base would be subject to state tariffing. NATA argues that this rate base could be permitted to remain in existence for a period specified by the Commission (NATA suggests the end of 1987). Under the NATA plan, AT&T would be barred from selling CPE in an amount less than net book value plus reasonable transaction costs; NATA asserts that premature sales under tariff at less than net book value could force ratepayers to bear the burden of unrecovered investment. NATA contends that retaining the embedded base under tariff would meet the question of the extent of

[36] AT&T has indicated to the Commission that, through September 1983, 7.5 percent of the embedded single-line base has been sold pursuant to state tariff programs. Letter from R. K. Graves to Chief, Computer II Staff, Common Carrier Bureau (Nov. 16, 1983). Multi-line equipment is not included in these state sale programs.

[37] The approach suggested by California apparently would require a waiver of Second Computer Inquiry rules because, under these rules, AT&T's fully separated subsidiary is authorized to engage only in activities which are no longer subject to tariff regulation.

Commission authority to impose requirements and restrictions upon ATTIS after the embedded base is removed from tariff service,[38] and that, although its approach would require AT&T to establish an EBO to maintain the embedded base after divestiture, AT&T has not demonstrated that this would entail substantial costs. NATA Direct Comments at 8–13; NATA Reply Comments at 1–2.[39]

43. Several factors have led us to reject the various forms of continued state tariffing suggested in the comments. Most importantly, the continuation of state tariffing would be a retrenchment from the course on which we have set out in *Second Computer Inquiry*. The basis of our decisions in that proceeding is the desire to end the distortions in the marketplace which are the unavoidable result of tariff regulation. The transition to a fully competitive CPE marketplace would be made more difficult, in our view, if any measure of state tariffing were allowed to remain in place. Several commenters share our view regarding the inappropriateness of state tariffing as a transitional device. *See, e.g.*, Ad Hoc Comments at 8; AT&T Reply Comments at 10. Further, it is our view that we have devised transitional mechanisms in this *Order* which fully protect the interests of ratepayers and in-place users while avoiding any need to keep state tariffing in place. We indicated in the *Notice* that continued state tariff regulation might be necessary if "a successful transfer plan is not developed under which a substantial majority of . . . embedded CPE is offered for sale under sufficient regulatory scrutiny so as to ensure that ratepayer interests are adequately protected." *Notice* at para. 24. We also indicated, as we have noted

[38] We have concluded that we have sufficient statutory authority to impose restrictions and requirements upon ATTIS regarding the embedded base. *See* Part IV, *supra*.

[39] NATA defends its proposals by arguing that continued regulation is necessary to protect ratepayer and user interests during the transition, and that its proposals are no more regulatory than proposals advanced by several other parties—including AT&T—under the banner of "deregulation." NATA Reply Comments at 1–3. NATA also maintains that these proposals made by other parties amount to "functional regulation" which flies in the face of the principles of Second Computer Inquiry. NATA then asserts that the Commission cannot turn its back on these principles in the proceeding which is intended to carry out Second Computer Inquiry requirements with regard to the embedded base. To do so, NATA alleges, would be an unlawful attempt by the Commission arbitrarily to call what are clear regulatory conditions "deregulation." NATA Reply Comments at 14–15 & 15 n.*. NATA overreaches in engaging in these semantic niceties. There is a continuum between "regulation" and "deregulation," and we have reached the conclusion that the most sensible means of progressing to a deregulated CPE marketplace is to move along this continuum during a transition period. Whether the requirements and restrictions we establish constitute "regulation" or "deregulation" strikes us as being beside the point. It is far more important to focus on the question of whether conditions should be imposed during the transition and, if so, what these conditions should be. We simply reject NATA's contention that, in pursuing this exercise, we somehow have engaged in "unlawful" arbitrary action.

here, that there are strong reasons for attempting to avoid any continued state tariffing of the embedded base. *See Notice* at paras. 22–23. We believe that the detariffing mechanism we adopt in this *Order* provides ample regulatory scrutiny and fully protects ratepayer interests. We therefore do not find that there is any need for state tariffing during the transitional period.

44. In addition, the possibility cannot be dismissed that substantial costs may be incurred because of the need for an EBO if the embedded base remains under state tariff. We drew attention in the *Notice* to our concerns regarding this matter. *See Notice* at para. 84. Several commenters object that AT&T has not "quantified" the costs which may be incurred if an EBO is required. *See, e.g.*, IDCMA Reply Comments at 6; NATA Direct Comments at 11; NATA Reply Comments at 32 n.*; NATA Comments on AT&T Response to Bureau Letter at 25. AT&T, in addressing EBO costs, has presented several factors arguing in favor of avoiding the need for establishing an EBO. AT&T points out that continued tariffing would require the EBO to establish tariffs in 49 state jurisdictions, and would require the state commissions to undergo the burdensome task of reviewing and acting on these tariffs. AT&T Reply Comments at 24. An EBO also would be required to establish separate billing, financial accounting, and other systems to meet varying state regulatory requirements, and this would generate costs to be borne ultimately by ratepayers. *Id.* at 24–25. AT&T also argues that the EBO would be a "wasting enterprise," in that it would not be able to replenish its stock and would be left with increasingly obsolete CPE. This, AT&T contends, would unduly handicap the EBO in the competitive arena. Further, as the size of the embedded base decreases, the costs of maintaining the remaining base would be spread over fewer ratepayers. *Id.* at 26. In attempting to quantify some of the incremental costs which would be associated with operation of an EBO, AT&T has estimated that $150 million in state regulatory expenses would be incurred over the five-year period ending at the end of 1987, and that $275 million in duplicative EBO service order, billing, sales support, data support, and other costs would be incurred over the same period. AT&T Response to Bureau Letter at 36–37, 37 n.**. Although it may be true that AT&T has not been able to quantify EBO costs with great precision, we conclude from the record before us that it is clear that some level of EBO costs will be incurred, that there is a risk that these costs could be substantial, and that ratepayers would be forced to bear these costs. We see no reason to force these costs onto ratepayers if a suitable transitional mechanism can be devised which eliminates any need for an EBO. We are establishing such a mechanism in this *Order*, and the transitional mechanism we are adopting obviates the need for any continued state tariffing of the embedded base.

B. *Valuation*

1. *Use of Net Book Value*

45. We have concluded that the definition of economic value proposed in the *Notice of Inquiry* should be adopted, and that net book value[40] of the embedded CPE base should be used as a surrogate for economic value for purposes of establishing sale prices and valuing the equipment to be transferred to ATTIS. As we have discussed,[41] the valuation issue encompasses two separate questions: arriving at a valuation standard, and measuring value based on this standard. With regard to the first question, we find no reason to alter our tentative conclusion that economic value is the proper valuation standard, and that economic value should be defined to mean the price a carrier would be willing to pay for its CPE if, instead of owning it, the carrier had the opportunity to purchase it. *Notice of Inquiry*, 89 FCC 2d at 697. None of the commenters has persuaded us that some other definition would serve as a better standard, and, in fact, there is virtually no comment on this issue in the most recent round of pleadings.

46. More difficult problems are posed by the second question. These problems stem primarily from the fact that we are confronting an event for which there is little precedent—the removal of billions of dollars worth of assets from regulated service. Adding to the problem is the fact that, for overriding reasons which we have discussed,[42] we are striving to ensure that the transfer of the embedded base to ATTIS can be carried out at the time of divestiture. These circumstances make it difficult to apply what ordinarily would be regarded as conventional means of arriving at the economic value of the embedded base. Such a mechanism for determining economic value would be to appraise all embedded CPE assets and use this appraised value for purposes of the sale program and transfer to ATTIS. This approach, however, does not lend itself particularly well to the asset transfer we are facing here. There is no possibility that such a valuation could be carried out before divestiture occurs. Even if we permitted the assets to be transferred to ATTIS before such an appraisal process could be completed, the sale program would have to be delayed so that sale prices could be based on appraised value. If we chose to keep the assets under regulation in an EBO established by AT&T pending completion of the appraisal process, the EBO operation would entail costs which would be borne by AT&T's ratepayers. In sum, delay, uncertainty,

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[40] Net book value is defined as the original cost of an asset less the related depreciation reserve.

[41] Para. 7, *supra*.

[42] Paras. 5–6, *supra*.

and costs to be assessed to ratepayers are the likely result of any attempt to carry out an appraisal of the embedded base.[43] Further, even if coordination with divestiture were not a factor so that ample time was available to conduct appraisals, it still is not clear that appraisals would be the most reasonable means of valuing the embedded base. The valuation process would be costly because of the vast size of the embedded base. These costs, whether borne by ratepayers or stockholders, constitute a major disadvantage of the appraisal method. Also, there is no assurance that appraisals would yield any precise results regarding economic value because transfers of this type, and on this scale, have never before been undertaken.

47. These considerations led us to conclude tentatively in the *Notice* "that the only workable alternative for measuring the value of the embedded CPE is net book value." *Notice* at para. 30. Net book value is a commonly accepted measure of a company's worth, and it serves as a simple, objective tool for carrying out a valuation of the embedded base, thus providing an important element of certainty in this complex valuation process. Further, this approach has received strong support from parties choosing to comment on this issue. ATU, for example, concludes that net book value is the only workable and concrete alternative for solving the valuation problem because it ensures the proper recovery of capital and it is harmonious with an effective deregulation plan. ATU Direct Comments at 2, 4. Colorado also argues that net book value is the only workable alternative for valuation. Colorado Direct Comments at 2. Other commenters also have expressed support for the net book value approach. *E.g.*, Idaho Direct Comments at 2; Illinois Direct Comments at 4; Kansas Direct Comments at 2; Tennessee Direct Comments at 4.

48. Three alternatives to the use of net book value as a surrogate for economic value are raised in the most recent pleadings. IDCMA and Tandy argue that the higher of fair market value and net book value should be used as the valuation method. IDCMA Direct Comments at 13; Tandy Direct Comments at 6–7. Tandy also

[43] The District Court has reached a similar conclusion in response to arguments in the divestiture proceeding that AT&T's assets should be appraised in connection with the division of assets under the divestiture. The District Court pointed to the extensive and complicated valuation proceedings in the Conrail litigation, noting that "[d]espite the fact that the valuation proceedings for these assets began in the mid-1970s, they have yet to be completed." United States v. AT&T, 552 F.Supp. at 205 n.309. The District Court went on to conclude:

> Valuation proceedings for the Bell System assets would necessarily be even more complicated and unmanageable than those involving Conrail, for the value of AT&T's assets is not only substantially greater than that of the Conrail assets, but the court there had at least the advantage of valuing assets from bankrupt estates. In contrast, the Bell System is an ongoing business, and market dynamics would therefore be of much greater significance here than they were in *Conrail.*

Id. at 205 (footnotes omitted).

suggests that actual valuation may not be as difficult as the Commission believes, and that it might be appropriate to assign this valuation task to the state commissions. Tandy Direct Comments at 10–11. Merely suggesting that the higher of fair market value and net book value should be the valuation measure begs the question of whether there are any workable means for establishing fair market value. In this regard, we do not find reassuring Tandy's assertions regarding the ease with which this could be done. Leaving this task to the state commissions could cause substantial delays in completing valuations because the state commissions would need time to devise rules and procedures for carrying out the task. Such an approach would not avoid the potentially high costs involved in conducting appraisals. Further, there is no guarantee that the state commissions would follow the same rules and methods in carrying out the valuation, and this could result in appraisal results based on widely varying premises and assumptions.[44]

49. North Dakota suggests that statistically valid random spot appraisals be used to ensure an accurate approximation of economic value. North Dakota Direct Comments at 4. Although this approach would cut back on the severity of the problems associated with appraising the entire embedded CPE inventory, it could still be an expensive undertaking and it is not likely that these spot appraisals could be completed before the time of divestiture. Nor is it clear what criteria could be used to ensure a statistically valid sampling. Finally, NATA argues that, since, in its view, the effect of setting the CPE transfer price at net book value simply is not known, the Commission should conduct an evidentiary hearing to establish the relationship between net book value and fair market value. NATA contends that it is unlikely that the Commission could justify failing to attempt to determine economic value, and that ratepayers could be harmed by such failure if economic value in fact exceeds net book value. NATA Reply Comments at 27–29. We cannot agree with NATA's assertion that we must devise such a means for measuring economic value. We have concluded that we can fulfill our responsibilities by using net book value as a surrogate for economic value so long as we adopt rules and procedures which provide investors with a fair opportunity to recover their investment and provide ratepayers with a fair opportunity to capture any gains which have accrued in the value of the embedded equipment. We are adopting the necessary rules and procedures in this proceeding and, therefore, the overall sale and transfer plan we have devised permits us to use net book value as a surrogate for economic value.

50. There remains one other issue relating to our use of net book value as a surrogate for economic value in connection with valuing the embedded base. AT&T has asserted at various times during this

[44] *Cf.* United States v. AT&T, 552 F.Supp. at 205 n.311.

proceeding that the economic value of the BOCs' embedded CPE base is less than its net book value, and that we must take this into account in devising our detariffing plan and applying the principles of *Democratic Central Committee*. *See, e.g.*, AT&T Direct Comments at 22. AT&T bases its conclusions on two assertions. First, AT&T contends that the "principal reason for the excess of net book over market value is the severe underdepreciation of the CPE investment." AT&T Reply Comments at 29. Second, AT&T asserts that net book investment in CPE assets exceeds the economic value of these investments because of "the mismatch of revenue and cost associated with those PBXs and other CPE provided pursuant to two-tier contracts." *Id.* at 30. Under these arrangements, customers pay for the capital cost of the CPE in initial payments which are usually spread over five years. These "up front" revenues are immediately available to the BOCs to reduce their revenue requirements, and the customer, after completing the initial payments, is not charged any further capital-related costs. AT&T Direct Comments at 24–25.

51. The difficulty we have with AT&T's arguments is that they assume that there is a nexus between economic value and net book value such that, if net book value can be said to be overstated, it automatically follows that net book must exceed economic value. For purposes of determining whether net book is a workable substitute for economic value in circumstances in which it is impractical to attempt to ascertain economic value, we are not willing to accept AT&T's assumption that such a nexus exists. If we take economic value to mean the price a carrier would be willing to pay for assets if the carrier, instead of owning the assets, found it necessary to replace the assets, then we can see that the economic factors which would determine that price are not necessarily indicative of any relationships between economic value and net book value. The critical fact in our present situation is that we do not know the economic value of the embedded base. Further, AT&T's arguments regarding underdepreciation and "up front" two-tier contract payments do not advance the inquiry regarding the level of economic value. Also, as commenters have indicated, AT&T has not made available any costing information to demonstrate the current level of the economic value of the BOCs' embedded CPE base. CBEMA Reply Comments at 4; NATA Reply Comments at 20; New York Comments on AT&T Response to Bureau Letter at 6.[45] AT&T's arguments

[45] AT&T has indicated that it is in the process of conducting an analysis of anticipated net revenues from embedded CPE. AT&T Response to Bureau Letter at 40. This analysis was not submitted to the Commission as of the date of the adoption of this Order. (AT&T had indicated that, if it were to submit the analysis, it would request protective conditions. *Id.*) Even if this analysis had been submitted, it would have been difficult for Commission staff to complete a review of the analysis in a timely manner, given the inherent difficulties in assessing criteria used in trying to estimate future net revenues and in trying to make

regarding the relationship between economic value and net book value also overlook the fact that more than the economic value of physical assets must be considered in order to assess with any accuracy the actual value which will be received by ATTIS. ATTIS will be receiving a "going concern" in connection with the transfer of the CPE base. Clearly, there is economic value in the goodwill associated with the established CPE business being transferred to ATTIS, and in the customer proprietary information which relates to the embedded CPE base. These sources of economic value must be taken into account in weighing AT&T's assertions regarding the economic value of the embedded base. We conclude, on the basis of all of these factors, that it would not be appropriate to adopt AT&T's assertions regarding economic value as a basis for abandoning our reliance upon net book value as a proxy for economic value. We come back to the fact that there is nothing in the record in this proceeding upon which we could rely as an accurate measurement of economic value. AT&T, by addressing itself to the question of whether net book value of the BOCs' embedded base is overstated, would have us draw conclusions regarding economic value by indirection. We find it better to adhere to our view that using net book value as a proxy for economic value "has the advantage of extreme simplicity, and it may be the most prudent approach in some cases given the practical difficulties of implementing other alternatives." *Notice of Inquiry*, 89 FCC 2d at 698.

2. *Disaggregation*

52. We indicated in the *Notice* that:

> It may be appropriate to apply [an] aggregated valuation approach . . . on the basis of the different classes of CPE. . . . Such an approach might be particularly necessary if any significant portions of the embedded base were not offered for sale to subscribers because the undervaluation of any such portion could result in a gain to the transferee entity rather than to the ratepayer.

Notice at para. 32. Several commenters suggest that establishing sale prices and valuation amounts on a disaggregated basis is necessary to avoid sale price manipulation by ATTIS. Ad Hoc, for example, asserts that ATTIS could engage in anticompetitive conduct by charging more than net book value in less competitive product lines and less than net book value in product lines which are subject to greater levels of competition.[46]

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adjustments for the uncertainty of these revenues. *See* Notice of Inquiry, 89 FCC 2d at 698. These difficulties would have been increased if interested parties were not given access to AT&T's submissions.

[46] Ad Hoc Reply Comments at 3; *see also* CBEMA Reply Comments at 4 (aggregate approach would give ATTIS too much flexibility in setting prices for particular classes); IDCMA Reply Comments at 9–10; Kentucky Direct Comments at 2 (valuing each product class separately would eliminate any price manipulation); NATA Reply Comments at 20 (even disaggregation into product classes may not

53. We shall require disaggregation on the basis of single-line and multi-line equipment.[47] The comments have not pointed out sufficient reason to require any further disaggregation for valuation and sale price purposes beyond these two categories. We reach this conclusion for the following reasons. First, our primary concern in suggesting the disaggregation approach was the prospect that AT&T could undervalue a particular product line, exclude that product line from its sale program, and thus capture gains relating to that product line by transferring it to ATTIS at the undervalued amount. The commenters, in addressing our disaggregation proposal, essentially ignore the fact that AT&T will not be able to engage in such maneuvers because the entire embedded base will be offered for sale by ATTIS. *See, e.g.*, AT&T Response to Bureau Letter at 4–5. At the time we adopted the *Notice*, a substantial portion of the multi-line base (*e.g.*, 1A Key systems) was not included in AT&T's proposed sale program. Since that time, however, AT&T has modified its program to include 1A Key, thus alleviating much of our concern. AT&T Direct Comments at 7.

54. Second, we do not agree with the views of some commenters that, even though AT&T's sale program now covers the entire embedded base, ATTIS still could engage in anticompetitive price manipulation unless we require disaggregation. We have concluded that the most effective means to guard against the possibility of anticompetitive conduct by ATTIS is to prevent any abrupt transition to a totally deregulated CPE environment. *See Notice* at para. 28. The procedures and requirements established in the subsequent Parts of this *Order* will have the effect of creating a transition to deregulation which will amply protect the interests of customers using embedded equipment as well as other vendors of new equipment. These procedures and requirements, together with growing competition in both single-line and multi-line CPE markets, make it unlikely that ATTIS would anticompetitively manipulate prices.

55. Third, it is not necessary to impose a level of disaggregation beyond that proposed by AT&T to achieve an equitable result from the perspective of both ratepayers and stockholders. From the point of view of ratepayers, requiring that the embedded base be offered for sale at prices which will not generate revenues in excess of net book value (plus reasonable transaction costs) ensures that any gains over net book value will not be captured by ATTIS. By requiring a

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be sufficient because ATTIS could overprice certain portions of particular class of products while not offering other portions of the class for sale at all). Other commenters also generally favor some form of disaggregation. FEA Direct Comments at 29; ICA Direct Comments at 9.

[47] For purposes of this disaggregation requirement, "single-line CPE" means residential and business single-line CPE, except that datasets shall be treated together with multi-line CPE. See para. 67 n.59, *infra*.

mechanism which gives ratepayers an opportunity to receive the benefit of any gains in value, through their purchase of the in-place equipment, we have satisfied the requirements of *Democratic Central Committee*. From the perspective of stockholders, our refusal to require further disaggregation of the embedded base means that ATTIS will have a degree of flexibility in establishing sale prices and transfer values for various portions of the embedded base, so long as overall sale prices and transfer values adhere to the net book value standard. As a result of this flexibility, ATTIS will be better able to achieve capital recovery for AT&T's stockholders. That is, ATTIS may price certain portions of the embedded base below net book value based on its judgment that doing so is an effective means by which sales to in-place users can be achieved. These sales would result in some return on investment, whereas, if the product line were required to be priced at net book value, the likelihood of sales would be decreased and stockholders would be forced to absorb the loss upon the transfer of the equipment. Similarly, ATTIS will have the option to price other portions of the embedded base above net book value, based on its judgment that market value for this equipment is above net book and that sales would not be depressed by prices above net book. Gains realized from these sales would offset other losses associated with transfer of the embedded base, thus aiding in the achievement of capital recovery. Such a mechanism is not unfair to ratepayers (because, as we have discussed, requiring that the embedded base be transferred at net book value ensures that ratepayers have an opportunity to capture overall gains above net book value in the aggregated embedded base), and this mechanism furthers our efforts to comply with the principles of *Democratic Central Committee*, which require that stockholders have an opportunity to obtain capital recovery and that ratepayers must bear any losses associated with assets removed from regulated service. It is important to stress that the ability of the sale program we are establishing to satisfy *Democratic Central Committee* requirements is dependent in part upon the establishment of sale prices which will promote purchases by in-place customers. Consequently, we would expect that the stimulation of a high level of sales will be a major factor in price selections made by ATTIS during the transition period.

C. *Democratic Central Committee*

1. *Background; Principles of the Decision*

56. The *Democratic Central Committee* decision[48] constitutes one

[48] Democratic Central Committee was decided along with the following companion cases: (1) Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n, 485 F.2d 847 (D.C.Cir. 1973). (2) Bebchick v. Washington Metro. Area Transit Comm'n, 485 F.2d 858 (D.C.Cir. 1973). (3) D.C. Transit Sys. v. Washington Metro.

of the first efforts by a reviewing court to examine in close detail the reasonableness of a regulatory agency's action in providing for the disposition of appreciation on public utility assets upon the removal of those assets from regulated service.[49] In 1968, the Washington Metropolitan Area Transit Commission (hereinafter transit commission) approved a modified version of fare increases requested by the D.C. Transit System, Inc.[50] The Democratic Central Committee argued in its petition to the District of Columbia Circuit Court of Appeals that the transit commission, in arriving at its decision regarding the level of fares, failed to take into account properly the amount of gain in properties which the utility had transferred from operating to non-operating status. The properties involved, which consisted of obsolete railway terminals and repair shops, had appreciated substantially in value since the time of their initial purchase. The court awarded the gains on all of the assets to ratepayers. The court found that the transit commission had required ratepayers to bear the burden of extraordinary costs associated with converting the transit system from a trolley and bus system to an all-bus system. The court held that ratepayers, therefore, should be entitled to any extraordinary gains resulting from the conversion. *Democratic Central Committee*, 485 F.2d at 812–13.

57. The court in *Democratic Central Committee* based its holding on two general principles. First, the court concluded that the right to gains follows the risk of loss. That is, if ratepayers have borne the risk of capital loss on assets in regulated service, then ratepayers are entitled to any gains in the value of the assets upon their removal from regulated service. *Id.* at 807. The court noted that "investors have been denied capital gains realized on disposition of utility assets where they have not borne the risk of loss associated with the holding of such assets." *Id.* (footnote omitted). The court concluded that "an investor can hardly muster any equitable support for a claim to appreciation in asset value where he has been shielded against the risk of loss on his investment, or has already been rewarded for taking on that risk." *Id.* at 806. Second, the court maintained that economic benefits must follow economic burdens. The court pointed out that "[r]atepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they

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Area Transit Comm'n, 485 F.2d 881 (D.C.Cir. 1973). (4) Democratic Cent. Comm. v. Washington Metro. Area Transit Comm'n, 485 F.2d 886 (D.C.Cir. 1973), *cert. denied sub nom.* D.C. Transit Sys. v. Democratic Cent. Comm., 415 U.S. 935 (1974). These cases hereinafter are referred to collectively as Democratic Central Committee, unless otherwise indicated.

[49] *See* Note, *Awarding In-Service Appreciation to Public Utility Ratepayers – Windfall or Perdition?* 11 Cal. W. L. Rev. 160, 167 (1974).

[50] D.C. Transit Sys., Order No. 773, 72 P.U.R.3d 113 (1968).

patronize." *Id.* at 808 (footnotes omitted). An economic burden is borne by ratepayers, reasoned the court, as a result of the fact that "utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service." *Id.* (footnote omitted). The court concluded:

> In situations where consumers have shouldered these burdens on an asset which produces a gain, the equities clearly preponderate in their favor. . . . Investors who are afforded the opportunity of a fair return on a secure investment in utility assets are hardly in position to complain that they do not receive their just due from the . . . public. On the other hand, it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates – to the full extent of the gain.

Id. at 810–11 (footnotes omitted). Having concluded that the transit commission's order must be set aside, the court then addressed the issue of appropriate relief necessitated by the fact that fares had been established and collected based upon the invalidated order. The court concluded that it would exercise its equitable powers to impose a restitutional remedy through a combined effort with the transit commission. *Id.* at 824–25, 828.

58. Most subsequent cases which have made reference to *Democratic Central Committee* have discussed its development of a restitutional remedy under its equity powers.[51] One recent decision, however, has cited *Democratic Central Committee* for the proposition that "each case must rest upon its own factual situation; the validity of each allocation of profits or losses depends upon the nature of the property transferred and a balancing of the equities involved." *Washington Gas Light Co.* v. *Public Service Commission*, 450 A.2d 1187, 1237 (D.C. 1982). In upholding the reasonableness of the regulatory agency's allocation to ratepayers of gains associated with certain propane gas sales, the court, again relying on *Democratic Central Committee*, noted that "[t]he more important inquiry in determining who should receive the gains . . . is the question of who has borne the risks and burdens associated with . . . maintenance [of the gas]." *Id.* at 1238. The Commission also has recognized that the *Democratic Central Committee* decisions are grounded in equitable principles. We have concluded that:

> [T]he rule announced in that case [*Democratic Central Committee*] is that neither the investors nor the ratepayers have a vested right to the gains from the sale of appreciated utility property. Rather, our task in this matter is properly to balance the investor and ratepayer interests so as to apportion gains and losses in the most equitable manner.

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[51] *See, e.g.*, Philadelphia Gas Works v. Federal Power Comm'n, 557 F.2d 840, 844 (D.C.Cir. 1977); Thompson v. Washington, 551 F.2d 1316, 1319 (D.C.Cir. 1977); Moss v. Civil Aeronautics Bd., 521 F.2d 298, 306 (D.C.Cir. 1975). Another case has relied on Democratic Central Committee for the rule that "fares or tolls must be fair and equitable to the transportation consumers . . .." Delaware River Port Auth. v. Tiemann, 403 F.Supp. 1117, 1124 n.12 (D.N.J. 1975).

American Telephone and Telegraph Co., Charges for Interstate Telephone Service, Docket No. 19129, Phase II, Final Decision, 64 FCC 2d 1, 66 (1977) (hereinafter *Charges for Interstate Service*). Our treatment of *Democratic Central Committee* in that case arose in connection with the disposition of proceeds from the sale of assets in account 103, "Miscellaneous physical property." We noted that, under the Uniform System of Accounts (USOA), account 103 is a non-rate base account, and that assets once in a rate base account but retired from service are placed into account 103 pending sale. The USOA at that time required that proceeds from these sales must be treated outside the rate base accounts as extraordinary income items. We reversed this USOA treatment, finding that the *Democratic Central Committee* "principles apply with equal force to capital gains on the disposition of AT&T's plant (which was once in the rate base) and that, under these principles, the gains in question here should benefit the ratepayer." *Id.*[52]

2. *Balancing of Interests in Commission Plan*

59. We have broad authority under applicable statutes and case law to fashion equitable procedures which properly balance ratepayer and investor interests in connection with the removal of the embedded base from regulated service. The importance of this balancing process is explicitly recognized by the court in *Democratic Central Committee*, but this aspect of utility regulation has its basis in antecedent case law. The Supreme Court, for example, has indicated, in assessing the provisions of the Natural Gas Act of 1938, 15 U.S.C. § 717, that "[t]he rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (hereinafter *Hope*). In that case, the Court gave wide latitude to regulatory agencies regarding the balancing of equities in the ratemaking process, holding that they are "not bound to the use of any single formula or combination of formulae in determining rates." *Id.* at 602. The Court more recently has reiterated the importance of the regulatory agency's balancing role, and the deference which should be given to the agency's actions. *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968). The courts also have recognized that, as a general matter, considerable weight should be given by the judiciary to the exercise of discretionary powers by regulatory agencies.[53]

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[52] The Commission subsequently has revisited and endorsed its treatment of Democratic Central Committee in Charges for Interstate Service, Dkt. No. 19129. *See* Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies), Dkt. No. 20188, Report and Order, 83 FCC 2d 267, 275–77 (1980).

[53] The Supreme Court, for example, in reviewing actions taken by this Commission in establishing a uniform system of accounts, held that "[t]his court is not at

60. *Democratic Central Committee* explicitly acknowledges the central importance of the balancing process enunciated in *Hope*:

> The investor's interest lies in the integrity of his investment and a fair opportunity for a reasonable return thereon. The consumer's interest lies in governmental protection against unreasonable charges for the monopolistic service to which he subscribes. In terms of property value appreciations, the balance is best struck at the point at which the interests of both groups receive maximum accommodation.

Democratic Central Committee, 485 F.2d at 806. As we already have noted,[54] the court in *Democratic Central Committee* joined forces with the transit commission to fashion a broad restitutional remedy in order to achieve this "maximum accommodation." It is important, however, to examine the actions taken in two other cases in the complex *Democratic Central Committee* litigation in order to gain an appreciation of the broad range of equitable remedies which the court considered appropriate to accommodate ratepayer and investor interests.

61. In *Bebchick v. Washington Metropolitan Area Transit Commission*, 485 F.2d 858 (D.C.Cir. 1973) (hereinafter *Bebchick II*),[55] the court sought to determine the best means of compensating the transit company's investors for a depreciation deficiency associated with certain properties which had been used in transportation operations. The basic question was whether ratepayers should be charged in the amounts necessary to offset this deficiency (through debits to a court-ordered riders' fund which had been established from invalidated fares in *Bebchick I* for the benefit of consumers) or whether gains in the value of the properties at the time they were removed from service should be recognized and applied to offset the deficiency. The transit commission, acting on remand from the court's decision in *Williams v. Washington Metropolitan Area Transit Commission*, 415 F.2d 922 (D.C.Cir. 1968), *cert. denied*, 393 U.S. 1081 (1969), refused to accept the view that the difference between the net book value of the properties and their higher market value at the time of removal could be viewed as reimbursement for the deficiency. The court in *Bebchick II*, relying upon the equitable principles it had set forth in *Democratic Central Committee*,[56] rejected the transit commission's decision.

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liberty to substitute its own discretion for that of administrative officers who have kept within the bounds of their administrative powers." American Tel. & Tel. Co. v. United States, 299 U.S. 232, 236 (1936) (Cardozo, J.).

[54] Para. 57, *supra*.

[55] The initial "Bebchick case" was decided 10 years earlier. Bebchick v. Public Utils. Comm'n, 318 F.2d 187 (D.C.Cir.), *cert. denied*, 373 U.S. 913 (1963) (hereinafter Bebchick I).

[56] *See* para. 57, *supra*. The court had also stated that:

> The allocation between investors and consumers of capital gains on in-service

62. The court noted that the key question was whether the transit company's investors could be said to have recouped their investment reflected by the deficiency. The court rejected the transit commission's view that the *Williams* decision precluded application of the increased value of the properties to offset the deficiency:

> The theory of the *Williams* remand on this point was that the riders' fund, being itself an equitable creation, should not be debited with the depreciation deficiency unless it was equitable to do so, and that it would not be fair and equitable if Transit's owners had already been compensated or reimbursed for that deficiency in some other form. Our stress was on the overall equities, not on formal or technical requirements or limitations, or on any single method of possible reimbursement.

Bebchick II, 485 F.2d at 870. The court reviewed the equitable principles set out in *Democratic Central Committee* —that the right to gains follows the risk of loss and that economic benefits must follow economic burdens—and concluded that "Transit's riders stand on solid ground in insisting upon an offset of the depreciation deficiency by a corresponding amount of the capital gains from transferred depreciable assets which Transit's investors have kept for themselves." *Id.* at 871–72. The court remanded to the transit commission for a determination of whether appreciation in the value of the properties was sufficient to offset totally the depreciation deficiency. These equitable principles were further extended in *Bebchick* v. *Washington Metropolitan Area Transit Commission*, 645 F.2d 1086 (D.C.Cir. 1981) (hereinafter *Bebchick III*), in which the court found that "[i]t is equitable that part of [the] full gain [on certain properties] should be allocated to the depreciation deficiency incurred while the properties were in operation." *Id.* at 1090.

63. These cases demonstrate the broad reach of the equitable principles underlying *Democratic Central Committee*. Put simply, the court in *Bebchick II* and *Bebchick III*, when faced with deciding upon appropriate disposition of gains in properties removed from the rate base, ensured that investors would not get a double benefit (to the ratepayers' detriment) by keeping the gains on the assets for themselves and also being reimbursed for depreciation deficiencies from other funds collected from ratepayers. By requiring that the gains be used to offset the depreciation deficiency, the court can be said to have improvised an equitable balancing to achieve the maximum accommodation of ratepayer and investor interests, in keeping with the principles of *Democratic Central Committee*. The cases are instructive in this proceeding because they signal the fact

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> assets . . . rests essentially on equitable considerations. The allocative process . . . necessitates a delicate balancing of the interests of investors and consumers in light of the governing equitable principles. The constant effort must be a distribution of the gains as fairness and justice may require.

Democratic Central Committee, 485 F.2d at 821 (footnotes omitted).

that we have a responsibility, in overseeing the removal of assets from the rate base, to exercise our authority in an equitable manner to ensure that ratepayer and investor interests are properly balanced.

64. In assessing our responsibilities in this regard, it is important to note a distinction between *Democratic Central Committee* and the circumstances of this proceeding which gives an even broader compass to our need to balance the equities. The assets involved in *Bebchick II* and *Bebchick III* were buildings which, upon removal from regulated service, were used in activities which had no relation to mass transit operations. *Bebchick II*, 485 F.2d at 872 (citing D.C. Transit System, Order No. 1090, 85 P.U.R.3d 508, 513 (1970)). This meant that the court, in dealing with the appreciation on the value of those buildings, was addressing a discrete event which would have only an indirect bearing on future mass transit operations in the Washington, D.C., area. This made it possible for the court to focus on the interests of a relatively narrow group of ratepayers and investors.[57]

65. In contrast, we are addressing in this proceeding the removal of assets from regulated service on an enormous and unprecedented scale. Further, the embedded CPE base, after its removal from regulated service, will continue to be an integral part of the Nation's telecommunications system. The significance of this, we conclude, is that the constituency for our accommodation of interests in this proceeding includes not only ATTIS and the BOCs' ratepayers, but also the national telecommunications industry and the population of current and future telecommunications customers. Congress has charged us with the duty to ensure that "all the people of the United States [have available to them] a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . .." Section 1 of the Communications Act of 1934, 47 U.S.C. § 151. Terminal equipment obviously is an essential link in the provision of this telcommunications service. We have decided in *Second Computer Inquiry* that the competitive marketplace constitutes the surest means of providing CPE in a manner which contributes to the efficiency and integrity of the telecommunications system. It hardly needs to be stated that removing the embedded CPE base from rate regulation in no way diminishes our responsibilities under the Act to provide for an efficient national telecommunications network. In fashioning a detariffing and transfer plan, and transitional procedures to prevent dislocations, we have been cognizant of the broad array of interests which must be balanced, and we are exercising our authority in this

[57] It also is instructive to note that the depreciation deficiency at issue in Bebchick II was approximately $1.1 million. Bebchick II, 485 F.2d at 868.

proceeding in an equitable manner which achieves the maximum accommodation of these interests.

66. In devising the detariffing and transfer plan, we have reached two central conclusions. First, we have concluded that it is not practical to attempt to determine the economic value of the BOCs' embedded CPE base, and that net book value will serve as an acceptable surrogate for economic value. Second, we have concluded that we can fashion a detariffing and transfer plan which meets the equitable principles of *Democratic Central Committee* even though the economic value of the embedded base has not been adduced.[58] As we have seen, *Democratic Central Committee* stands for the principle that regulators must seek the maximum accommodation of ratepayer and investor interests in connection with the removal of assets from the rate base. *Bebchick II* and *Bebchick III* indicate that there is wide discretion in reaching this accommodation. Our approach to the issues of disaggregation and the sale of the embedded base has enabled us to achieve this accomodation in a manner which fully comports with the principles of *Democratic Central Committee.* We have devised a plan which treats ratepayers and investors fairly—ratepayers are given an opportunity to capture gains in the value of assets through the sale plan, while investors are given an opportunity to recoup their investment through the pricing and valuation flexibility we have accorded ATTIS by our decision not to impose disaggregation requirements. Further, we have utilized our equitable powers to fashion a workable detariffing and transfer plan made necessary by the extraordinary nature of the circumstances confronting us. Finally, we have fulfilled our statutory responsibility to protect the integrity of the national telecommunications system by structuring a transition mechanism which will minimize disruption to users while also enabling ATTIS to succeed the BOCs in servicing the embedded base without having to face unnecessary impediments.

VI. RESIDENCE AND BUSINESS SINGLE-LINE CPE

A. *Sale Plan*

1. *Prices and Sale Procedures*

67. AT&T proposes to offer consumer CPE[59] for sale at an-

[58] For a discussion of the relationship between the economic value and the net book value of the embedded base of the BOCs, see Part V.B.1., *supra.* For a general discussion of the Commission's detariffing and transfer plan, see Part V.A., *supra.*

[59] For purposes of its proposal, AT&T has defined "consumer CPE" to mean both residence CPE and single-line business CPE. References to "single-line CPE" also encompass both residential and business single-line CPE. AT&T has indicated that single-line equipment is comprised of rotary and Touch Tone models of the standard, Princess, and Trimline telephones, and has also pointed out that "single-line CPE" does not include such telephone equipment if it is used on a

nounced prices[60] which will be maintained for at least two years after the date of divestiture.[61] AT&T has indicated that the sale prices for consumer CPE are based on net book value,[62] tax effects, and transaction costs. AT&T Direct Comments at 11–12; AT&T Reply Comments at 20 n.**; AT&T Response to Bureau Letter at 9. Customers will be notified shortly before detariffing that they have an option to purchase or to continue leasing their single-line CPE. Materials included in BOC bill inserts will request customers to choose between buying and leasing. The steps necessary to make either choice will be the same. A failure by the customer to respond will be treated as a decision to continue leasing. AT&T Further Supplementary Comments at 9 & nn.* & **. We expressed our tentative view in the *Notice* that AT&T's proposed prices for single-line CPE had reduced significantly the risk that ATTIS would have the capacity to engage in anticompetitive pricing practices. *Notice* at para. 36.

68. There is not a substantial amount of comment regarding the adequacy of AT&T's sale prices, although there is some suggestion that the prices do not bear any demonstrable relation to net book value. CBEMA Direct Comments at 4; ICA Reply Comments at 5; Michigan Direct Comments at 2. Other comments argue that AT&T should be required to establish different sale prices in each state so that these prices can reflect differences in net book value in the different states. Illinois Direct Comments at 6; North Dakota Direct Comments at 5–6.

69. Before addressing the particular concerns raised in the comments, we make some general observations regarding the adequacy of AT&T's sale plan for single-line equipment. First, the facets of the AT&T plan must be viewed from a perspective which also recognizes that there is vigorous competition in single-line telephone equipment. Large numbers of retail suppliers throughout the Nation are selling telephone equipment featuring a wide range of styles and prices. *See* para. 4 n.8, *supra*.[63] In addition, the MFJ

PBX, key, ESSX/Centrex, or similar business system. AT&T Direct Comments at 6 n.*. The estimated net book value of residence CPE is $2.75 billion, and the estimated net book value of single-line business CPE is $153 million. *Id.*, Appendix C, at C1.

[60] See para. 11 n.15, *supra*, for a listing of these announced prices. These sale prices will not be subject to increases based on CPI during the transition period. *See* para. 78 n.70, *infra*. AT&T has indicated that the sale prices for refurbished consumer CPE "may be higher. . . ." AT&T Further Supplementary Comments, Mar. 29, 1983, at 8. For a discussion of the refurbishment issue, see paras. 200–203, *infra*.

[61] AT&T Further Supplementary Comments, Mar. 29, 1983, at 8.

[62] "Net book value" refers to net book value reflected on the regulated books of account. AT&T Response to Bureau Letter at 7 n.*. See para. 45 n.40, *supra*, for a definition of net book value.

[63] Radio Shack, for example, advertises a telephone similar in appearance to a

permits the BOCs to retail all types of CPE, including single-line CPE, and there is a reasonable expectation that the BOCs will compete vigorously in single-line equipment. It is our view that the nature and extent of this competition provide consumers with ample choices if they do not wish to purchase their in-place telephones from ATTIS. Second, the sale programs currently being conducted by the BOCs under state tariffs have given in-place customers an additional opportunity to purchase their telephones. As we have noted,[64] through September 1983 7.5 percent of embedded single-line sets had been purchased under tariffs in effect in all but three state jurisdictions. Third, AT&T began a nationwide advertising campaign in July 1983 to augment the state sale program in an effort to encourage customer purchases. This advertising program, which will cost approximately $12 million and includes prime-time television network spots as well as advertisements in national magazines, is a further step toward aiding consumers in making informed choices regarding their telephone equipment. In view of these considerations, we conclude that the AT&T single-line sale proposal is satisfactory and it is hereby approved. The consumer options reflected in the plan, coupled with the strong competition in this market, have combined to ensure that in-place customers are not disadvantaged by detariffing the single-line embedded base.

70. With regard to the relationship between sale prices and net book value, we already have noted that AT&T is committed under the plan we are approving to base its sale prices on net book value. Para. 67, *supra*. We are confident that reliance can be placed in this commitment for two reasons. First, we shall require AT&T to submit monthly reports to us during the transition period which indicate the amount of single-line embedded CPE sold by ATTIS, the revenue from these sales, and the relationship between this revenue and the adjusted net book value at which the single-line embedded base was transferred to ATTIS. This information will assist us in monitoring the sale program as it progresses to ensure that the established sale prices bear the required relationship to net book value, and will enable us to implement corrective measures under our statutory authority if necessary. Second, we reiterate our earlier comment that the competitive marketplace is a dependable check upon

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Touch Tone, Trimline telephone at $29.95. AT&T Reply Comments, Dec. 3, 1982, at 30. Tandy, which owns Radio Shack, has approximately 7,000 Radio Shack outlets nationwide. AT&T Reply Comments at 21 n.**. Public Phone Stores, a retailer with eight outlets in the Washington, D.C., area, advertises a telephone which resembles the Touch Tone standard telephone and features automatic last number redialing at $39.88. Wash. Post, Oct. 21, 1983, at A16, cols. 5–6. Brothers Cameras & Electronics, a retail outlet with several branches in the New York City area, advertises a Webcor telephone which features 16-number automatic dialing and automatic memory redialing at $79.95. N.Y. Times, Oct. 26, 1983, at A25, col. 5.

[64] Para. 41 n.36, *supra*.

manipulative pricing by ATTIS. If the announced prices we are approving are too high, in the sense that they would generate gains for ATTIS above net book value, in-place customers have sufficient alternatives in the marketplace.

71. With regard to the suggestion that the sale program should be conducted on a state-by-state basis, we conclude that there is not sufficient benefit to outweigh the difficulties of such an approach.[65] It is apt to point out that such a requirement would merely amount to the continuation of state regulation, and we conclude that such regulation no longer is warranted in the single-line equipment market. We reject the view that the plan we approve here is defective because it may deprive ratepayers in certain states of gains above the net book value of the equipment in their states. No one in this proceeding has advanced a credible argument that *Democratic Central Committee* or any other judicial ruling requires us to force the application of a net book value test for a sale plan in each state. We do not consider ourselves to be under any such judicial mandate, nor do we perceive such an approach as being practical or in the public interest. If responsibility for devising sale programs were left to the states, the disparate requirements and policies which inevitably would result could very easily fall short of satisfying the equitable principles of *Democratic Central Committee*. Further, if each state were to have a role in establishing sale prices for equipment transferred to ATTIS, their attempts to do so would introduce further uncertainty and delay. It is not sufficient to argue that the states could simply continue in force the sale prices they already have approved in the BOC tariffs because many states might take this opportunity to reevaluate their initial determinations and establish new prices. There is the further possibility that transaction costs would be increased if ATTIS were required to maintain different sets of prices in each jurisdiction. Higher transaction costs, of course, would constitute a direct detriment to consumers.

2. *Transaction Costs*

72. The announced sale prices for single-line equipment include transaction costs which reflect the costs ATTIS will incur in connection with conducting the sale program. In response to our inquiry,[66] AT&T has submitted an explanation of the manner in which these costs will be calculated. The costs are broken down into the following categories: warranty expenses, service order and paperwork, warranty card and ownership sticker, local promotional expense, and administrative expenses. AT&T indicates that warranty expense is determined by calculating the cost of repairing one set

[65] Both AT&T and FEA oppose such a state-by-state approach. AT&T Reply Comments at 11–12; FEA Reply Comments at 7.

[66] Notice at para. 13 n.12.

(the sum of the expense for manufacturer's repair, handling, packing material, transportation, and replacement cord) and multiplying this expense by the one-month failure rate (determined from BOC data). AT&T notes that this expense varies by product line because manufacturer's repair charges, cord costs, and equipment failure rates vary by product line. Regarding service orders and paperwork, AT&T indicates that a record order is necessary to discontinue billing for CPE leasing. BOC costs for this record order have been used in calculating transaction costs for ATTIS and the average record order is assumed to cover 1.2 sold sets. Paperwork costs are estimated with reference to clerical time plus mailing costs. Service order and paperwork expenses do not vary among product lines. The warranty card and ownership sticker involve material costs which do not vary among product lines. Local promotional expenses are based on one bill insert and also do not vary among product lines. Administrative expenses involve a loading on gross investment to cover a portion of corporate overheads. AT&T notes that its approach is commonly used in state ratemaking, and that administrative expenses vary among products because investment varies. AT&T Direct Comments, Appendix D, at D1.

73. Several commenters suggest that the Commission should take any steps necessary to ensure that ATTIS's transaction costs are reasonable. Ad Hoc Direct Comments at 11; Ad Hoc Reply Comments at 4–5; FEA Reply Comments at 7; ICA Direct Comments at 26–29. One commenter argues that the Commission should launch a separate inquiry into the question of transaction cost methodology. Tandy Direct Comments at 10–11. Another commenter maintains that a specific floor and ceiling should be established by the Commission for transaction costs. California Direct Comments at 6 ($3.00 floor and $6.00 ceiling).

74. We conclude that the approach to transaction costs proposed by AT&T is acceptable and does not warrant the imposition of additional regulatory requirements. We are satisfied with AT&T's explanation that variation in AT&T's prices among single-line product categories is primarily attributable to differences in net book value and to the fact that AT&T has sought to establish prices attractive to customers while also providing for the recovery of costs. AT&T Direct Comments at 13. AT&T also points out that variations in transaction costs among product lines average less than 18 percent (or approximately $1.70). *Id.* at 12–13. We stress our earlier conclusion that competition for single-line equipment is a sufficient gatekeeper; any attempt by ATTIS to manipulate sale prices through its transaction cost methodology would be checked by the ability of consumers to turn to the marketplace for alternatives. We have sought to point out during this proceeding, and in *Second Computer Inquiry*, that regulation should be removed if it is not needed. We are convinced that we need not impose any regulatory requirements

with regard to transaction costs in order to protect the public interest.

B. *Monthly Lease Plan*

75. AT&T has announced monthly lease rates for six categories of residence CPE.[67] See para. 11 n.15, *supra.* These rates will be in effect for at least two years following the date of divestiture. Under AT&T's proposal, if standard rotary customers are currently paying less than $1.00 per month under tariff in a particular state, the rate established by ATTIS at the time of divestiture for those customers will be no more than $.50 higher than their current rate. For any such customers, the monthly rate will not be increased by ATTIS to $1.50 until January 1, 1985. AT&T Direct Comments, Appendix B, at B2. For residence CPE other than standard rotary, the maximum price increase at the time of divestiture[68] will be $1.00 over the current lease price. *Id.* at B3.[69] These rates will not be subject to any increase by ATTIS until October 1, 1984. AT&T Supplementary Comments, Oct. 28, 1982, at 17. If existing lease rates for any category of residence CPE are higher than ATTIS's national prices, these rates will be reduced to ATTIS's specified level on January 1, 1984. AT&T Direct Comments, Appendix B, at B3. During the

[67] AT&T has indicated that its proposed monthly charge option applies only to residence, and not single-line business, CPE. AT&T Further Supplementary Comments, Mar. 29, 1983, at 4; *see* AT&T Direct Comments, Appendix B, at B2-B4. Single-line business CPE will be subject to the monthly lease rate requirements we establish for multi-line CPE. See Part VII.D., *infra.* It also should be noted that AT&T initially refused to announce any monthly lease rates for residence CPE, indicating only that these rates would not exceed the highest state tariff in effect or filed. AT&T Reply Comments, Dec. 3, 1982, at 23.

[68] AT&T has indicated that price increases and decreases for all embedded CPE which are scheduled for January 1, 1984, under its plan may have to be deferred until March 1, 1984, "because of the extreme work loads placed on BOC Comptrollers during this period." AT&T Direct Comments, Appendix B, at B2. We make no objection to this reasonable contingency included in the AT&T plan. We do, however, require AT&T to furnish us with written notice, not later than 30 days after the release date of this Order, regarding whether such a postponement will be necessary. We also note that, if there is such a delay, then requirements we are establishing regarding the calculation of multi-line CPE lease rates shall apply at the time those rates are actually implemented by ATTIS. *See* para. 108, *infra.*

[69] AT&T previously had indicated that initial increases for standard rotary and other residence CPE would be based on state tariffs in effect *or filed.* AT&T Further Supplementary Comments, Mar. 29, 1983, at 10–11. AT&T's most recent iteration speaks in terms of increases over the "current price." AT&T Direct Comments, Appendix B, at B2-B3. We shall require that the tariff in effect on December 31, 1983, be used as the basis for calculating the maximum lease rate increases for residence CPE. For purposes of our decision in this Order, any reference to a tariff "in effect" on a specified date shall be construed as a reference to the actual tariff rate applicable on such date, without regard to any subsequent changes resulting from pending filings or ongoing investigations by the regulatory agency involved.

transition period, ATTIS will repair or replace, at no charge, embedded consumer CPE which is brought to designated central facilities. Replacement CPE also will be mailed to users at no charge. Repair or replacement for a charge will be made at a customer's premises upon request.

76. We indicated generally in the *Notice* that AT&T's revised proposal would seem to allay concerns regarding the possibility of anticompetitive pricing policies. *Notice* at para. 36. A few states object to AT&T's proposed lease rates because they would represent increases over rates currently in effect under tariff. Colorado Direct Comments at 1; Michigan Direct Comments at 3; Oregon Direct Comments at 2. It is our view that these objections have failed to demonstrate that residential customers are not adequately protected under AT&T's proposal and, therefore, we shall approve the proposed monthly lease rates for residential CPE.

77. As AT&T has pointed out, its proposed monthly rate for standard rotary, or a higher rate, has been approved in tariffs in 22 states and its proposed rates for other categories have been approved in their entirety by 17 states. AT&T Reply Comments at 18 & n.*. AT&T also notes that the $1.50 monthly rate for standard rotary "is within *one cent* of the weighted average price in effect nationwide as of January 1, 1983." *Id.* at 18 (emphasis in original). Although it is true that lease rates in some states will increase under the plan we are approving, this is not dispositive of the question of whether the plan is equitable from the perspective of residential customers. Rates in other states will decrease under the plan, and, in states in which increases will occur, the level of these increases in 1984 is limited. Further, we return to our earlier conclusion that the competitive marketplace offers ready relief to those residential users who may not wish to continue leasing equipment from ATTIS. Expanded competition in the residential CPE market makes it unnecessary for us to impose restrictions upon ATTIS in addition to those already encompassed in AT&T's plan.

C. *Adjustment of Lease Rates*

78. AT&T has proposed that its announced lease rates for residence CPE, other than standard rotary, may be increased during the transition period by percentage rates which do not exceed the rate of increase in CPI during the transition period. *See, e.g.*, AT&T Further Supplementary Comments, Mar. 29, 1983, at 11.[70] AT&T

[70] It is our understanding that AT&T's initial proposal contemplated increasing sale prices for consumer CPE based upon CPI increases, but that AT&T no longer is making such a proposal. *Compare* AT&T Supplementary Comments, Oct. 28, 1982, at 17 *with* AT&T Further Supplementary Comments, Mar. 29, 1983, at 8; *see* Notice at para. 40. In any event, we conclude that AT&T shall not be authorized to increase sale prices for consumer CPE during the transition period. Further, AT&T's monthly charge plan also includes the proposal that increases in monthly lease rates could exceed the CPI rate of increase during the transition

notes that, because the monthly lease rate for standard rotary phones will be frozen during the transition period, "the overall national charges established by [ATTIS] will rise by no more than 60% of the rate of increase in the CPI during the two years after detariffing . . .." *Id.* In the *Notice* we expressed the tentative view that use of CPI is not "an unreasonable surrogate to compensate for increases in the cost of doing business . . .." *Notice* at para. 40. Several commenters have urged us to reject use of CPI as an escalator for monthly lease rates, arguing that this approach could cause large increases, that there is no direct relationship between costs and CPI, and that costs associated with the monthly lease program actually could decline during the transition. Ad Hoc Reply Comments at 4; Colorado Direct Comments at 3–4; New Jersey Direct Comments at 2; Tennessee Direct Comments at 5; Virginia Direct Comments at 5; Wisconsin Direct Comments at 4–5.

79. We conclude that it is permissible to use CPI as a basis for adjusting lease rates for residence CPE (other than standard rotary) during the transition, basing our conclusion on the following factors. First, we are convinced that the competitive marketplace for residence CPE will act as a sufficient check upon sharp increases in lease rates by ATTIS. Any such action by ATTIS would risk losing in-place customers to a growing host of competitors in single-line equipment. The wide range of options currently available to customers, both in terms of types of single-line telephones and in terms of the number of retail outlets (including direct mail outlets) for these telephones, makes it unlikely that ATTIS would be in a position to impose unrealistically high lease rates. Second, it is a fair assumption that the embedded base of single-line plant held by ATTIS will continue to decrease during the transition period as a result of the sale program and consumer decisions to purchase from other vendors. A number of costs, such as those associated with personnel, computer systems for accounting, and other overhead, could remain at substantially the same level even though revenues would be dwindling because of the decreased size of the embedded single-line base.

80. Third, the cost of doing business in connection with leasing

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period as a result of "extraordinary cost increases . . .." AT&T Reply Comments, Dec. 3, 1982, at 20. In discussing its original proposal for the increase of sale prices for consumer CPE, AT&T indicates that, if it contemplates any such increase, it "will seek the advance agreement of the Commission." AT&T Supplementary Comments, Oct. 28, 1982, at 17. We conclude that this is an acceptable procedure for the consideration of any extraordinary lease rate increases during the transition and, therefore, AT&T shall be required to obtain such approval before making any increase in lease rates which exceeds the CPI rate of increase. In addition, because of the wide use of standard rotary sets and AT&T's commitment to hold the lease rate for these sets at $1.50 during the transition, we would be less inclined to act favorably on any request for increases in the standard rotary lease rate.

the embedded single-line plant during the transition can be expected to rise as a function of general inflation rates during that period (*e.g.*, labor costs for billing and maintenance). The removal of this equipment from tariffed regulation eliminates the traditional manner in which costs could be recovered (*i.e.*, through rate increases approved by regulators). After the transition, ATTIS will be in a position to recover its costs in the competitive marketplace because it will have complete pricing flexibility. ATTIS has committed itself, however, to specified lease rates during the two-year transition. In view of this commitment, we find it reasonable to replace the tariff mechanism with some other means of permitting lease rate adjustments. Finally, it is important to recall that standard rotary sets will not be subject to any CPI rate increases during the transition period. Since standard rotary telephones comprise approximately 42 percent of in-place sets expected to be in service in 1984, it can be seen that nearly half of the embedded single-line plant will not be subject to CPI rate increases. *See* AT&T Further Supplementary Comments, Mar. 29, 1983, at 10. Also, the level of recent increases in CPI has not been dramatic,[71] thus giving rise to the reasonable expectation that use of CPI will not result in significant increases in lease rates over the next two years. All these factors, coupled with the fact that CPI is a readily identifiable and commonly used measure which encompasses all the factors which could give rise to cost increases for ATTIS, lead us to find that CPI is an acceptable basis for adjusting residence CPE (other than standard rotary) lease rates during the transition.

D. *Other Issues*

81. AT&T proposed that the transition period for single-line CPE should be two years. *See, e.g.*, AT&T Further Supplementary Comments, Mar. 29, 1983, at 11. Several commenters have suggested longer periods. *See* Colorado Direct Comments at 4; FEA Direct Comments at 16–18; Michigan Direct Comments at 4–5; Tandy Direct Comments at 9. We tentatively rejected any extension of AT&T's proposed price predictability period, *Notice* at para. 38, and nothing in the comments persuades us to alter our tentative view. Single-line customers already have the opportunity in most states to purchase their in-place CPE under state tariff; hence, the transition to a deregulated environment for embedded single-line CPE is already well under way.[72] Further, since AT&T already has an-

[71] The rate of consumer price inflation (based on unadjusted indexes) was 12.4 percent for 1980, 8.9 percent for 1981, and 3.9 percent for 1982. *Economic Report of the President* 225 (1983). The rate for the 12-month period ending in June 1983 was 2.6 percent. Wash. Post, July 23, 1983, at A1, col. 4.

[72] We have sought to encourage the states to establish these tariffed sale programs. *See* Notice of Inquiry, 89 FCC 2d at 696.

nounced the sale and lease prices which will apply during the transition, single-line customers will have the benefit of price stability over the full two-year period, in addition to their current opportunity to purchase their CPE under state tariff sale programs. Finally, the choices available in the marketplace for single-line customers are a potent argument against imposing further requirements upon ATTIS in this area.

82. With regard to warranties in connection with the purchase of embedded residence and business single-line CPE, the provisions of AT&T's proposed plan are not clear. AT&T has indicated that CPE purchased from the BOCs this year under state tariff sale programs will carry 90-day limited warranties for items purchased from inventory and 30-day limited warranties for items purchased in place. AT&T Supplementary Comments, Oct. 28, 1982, at 16.[73] AT&T also has indicated that "a 90-day warranty [will apply] in connection with the sale of all embedded multi-line CPE." AT&T Response to Bureau Letter at 13. AT&T does not address this question in its most recent summarization of its plan. *See* AT&T Direct Comments, Appendix B. Colorado has proposed that a 90-day warranty be applicable for all embedded single-line CPE. Colorado Direct Comments at 4. Another commenter considers the 30-day and 90-day periods to be adequate. Kansas Direct Comments at 3. We conclude that AT&T shall be required to provide a 90-day warranty for in-place sales of embedded single-line CPE. The terms of the warranties shall be those specified by AT&T in its earlier pleadings. *See* AT&T Supplementary Comments, Oct. 28, 1982, Appendix A, at A7-A9.[74] We can discern no grounds for differing warranty periods for single-line CPE (whether in-place or inventory) on the one hand, and multi-line equipment on the other.[75]

83. With regard to interest charges for installment purchases of

[73] Sales from inventory are given the same warranties as new equipment, even though this equipment is considered to be "embedded" CPE under Second Computer Inquiry rules. *See* para. 1 n.5, *supra*. The shorter 30-day warranty applies to CPE actually in use at the time of purchase.

[74] AT&T has indicated that the limited warranty for telephone housings and cords will apply only to the 90-day warranties under the BOC sale programs. AT&T Supplementary Comments, Oct. 28, 1982, Appendix A, at A7. We presume the reason for this distinction to be the fact that the housing and cord of a telephone are more susceptible to accidental or abusive harm while in place than are the internal electronics of the telephone. We find this distinction to be reasonable and shall permit ATTIS to exclude warranty coverage for telephone housings and cords in connection with in-place purchases. We also note that we accept AT&T's proposals regarding the terms and conditions of warranties for multi-line CPE. *See* para. 112, *infra*.

[75] It is also our hope that AT&T will seek to ensure that replaceable spare parts are made available in normal repair channels so that consumer CPE can be repaired, if necessary, after expiration of the warranty period. *See also* Part VII.B., *infra*. AT&T itself recognizes the importance of the availability of spare parts for a reasonable time period. *See* para. 97, *infra*.

single-line equipment, we have expressed our tentative view that such interest assessments should be permitted. *Notice* at para. 42. In comments on the *Notice*, Colorado argues that interest charges should be prohibited. Colorado Direct Comments at 4. Another commenter argues that interest charges should be permitted, with rates set by the telephone companies based on prevailing market conditions. Centel Direct Comments at 6. A third approach would be to require ATTIS to set interest rates at the same level as rates it sets for interest on new equipment purchases. ICA Direct Comments at 30. We find no reason to alter our tentative view. This is a standard business practice, and there is no suggestion that ATTIS would engage in this practice in a manner detrimental to consumers. There is reason to assume that prevailing conditions will govern ATTIS's decisions regarding interest rates, as suggested by Centel, and ATTIS's decisions will also be subject to applicable state usury laws. There seems little need for regulatory intrusion regarding this matter.

84. We tentatively found in the *Notice* that party-line equipment should be included in the AT&T sale program. *Notice* at para. 13.[76] Several commenters support our suggested approach. *See, e.g.*, Kansas Direct Comments at 2. AT&T notes that ATTIS "will—in those jurisdictions where it is permitted by state regulators—make embedded party-line CPE available for purchase, just as it will make such CPE available for lease." AT&T Direct Comments, Appendix B, at B1 n.*. Since we are dealing in this proceeding with a national detariffing program for all embedded CPE, we see no reason to make the sale and detariffed leasing of party-line CPE owned by AT&T contingent upon state policies. We therefore shall require ATTIS to offer party-line CPE for sale in all jurisdictions, subject to suitable conditions regarding repairs, as appropriate, to ensure that malfunctioning party-line CPE does not impair the service of other parties.

85. We indicated in the *Notice* that this proceeding does not apply to specialized CPE for disabled persons which is the subject of *Second Computer Inquiry* waivers we have previously granted. *Notice* at para. 2 n.4. AT&T argues that the treatment of this specialized CPE should be resolved in this proceeding in order to avoid potential costs which would be incurred in connection with the establishment of an EBO by AT&T to maintain this equipment under tariff. AT&T Direct Comments at 13 n.*. Michigan supports our view that this proceeding should not apply to CPE for the disabled, and argues that Congress did not intend, in enacting the Telecommunications for the Disabled Act of 1982, Public Law 97–140, for the Commission to have authority to require the detariffing of this CPE. Michigan Reply

[76] Party-line service involves the sharing of a common line to the telephone company's central office. A party line may be shared by two, four, eight, or more customers. Special CPE must be provided in conjunction with this service.

Comments at 1–2. We will address the merits of this issue in a separate proceeding which currently is in progress and which will prescribe rules not later than January 3, 1984, in compliance with the Telecommunications for the Disabled Act of 1982. *See Access to Telecommunications Equipment by the Hearing Impaired and Other Disabled Persons*, CC Docket No. 83–427, Notice of Proposed Rulemaking, FCC 83–176, 48 Fed. Reg. 20771 (released May 4, 1983). In light of this separate proceeding, specialized CPE for the disabled is excluded from this *Order*. We also note that we recently dismissed a price predictability and sales plan submitted by AT&T in that proceeding, concluding that leaving to the states the decision whether to detariff specialized CPE will best meet the purposes of the Telecommunications for the Disabled Act. *Id.*, CC Docket No. 83–427, Memorandum Opinion and Order, FCC 83–517, at para. 9 (released Nov. 25, 1983).

VII. MULTI-LINE CPE

A. *General Discussion*

86. Although we consider AT&T's proposals regarding the sale and transfer of single-line CPE to be sufficient to meet our regulatory concerns and the equitable requirements of *Democratic Central Committee*, we cannot reach the same conclusion with regard to AT&T's plan for the sale and transfer of multi-line CPE. We therefore shall require AT&T to comply with certain revisions to its proposed plan as described in the following sections. In broad outline, we will permit the entire multiline base to be detariffed and transferred to ATTIS at divestiture. We also shall provide that the transition period shall begin to run only at the time each category of CPE is offered for sale, not at the date of divestiture. Further, we shall require a two-year transition period, rather than the 18 months proposed by AT&T. If a particular category of CPE is offered for sale by ATTIS at the time of divestiture,[77] then the national lease rates

[77] AT&T has indicated that it will offer for sale at the time of divestiture that embedded CPE which also is offered for sale as new equipment by ATTIS. AT&T Further Supplementary Comments, Mar. 29, 1983, at 12. AT&T has noted that this will include Dimension PBXs, Horizon communications systems, multi-button electronic telephone sets, voice terminals (including Com Key, Touch-A-Matic 32 Automatic Dialer, Speakerphone, Comm-Stor, and voice paging), data communications equipment (including Dataphone II and Series 100, 200, and 300 modems), data terminal equipment (including Dataspeed 40, printers, the 34 Teleprinter, Dataspeed 4540, and the 1000 Teleprinter), and teleconferencing equipment. *Id.* at 12; Attachment A, at A1. AT&T also has indicated that type 556 and type 557 embedded cord boards "will be offered for purchase at the time of detariffing." *Id.* at 13.

It should be noted that AT&T, as part of its response to the Bureau Letter, submitted a listing of purchase prices for in-place multi-line CPE it intends to offer for sale at the time of divestiture, and requested confidential treatment of this information. AT&T Response to Request for Information, Request for Confidential

announced by AT&T will immediately apply to that category and the transition period will begin to run immediately at the time of divestiture. If, however, a particular category of embedded CPE is *not* offered for sale by ATTIS at the time of divestiture,[78] then customers leasing that equipment will continue to lease at rates which are equivalent to tariff rates in effect in the states involved at the end of 1983 (if these rates are less than the initial minimum lease rate established by ATTIS). At the point AT&T initially offers any such category of CPE for sale to in-place customers, AT&T's announced national lease rates for the category involved may go into effect and the two-year transition period for that category of CPE will begin to run.[79] This approach eliminates any need to require AT&T to file state tariffs through an EBO for the embedded multi-line base after divestiture.[80]

87. We find the imposition of these requirements to be necessary because AT&T's proposed sale and transfer plan for multi-line equipment does not satisfy the regulatory objectives we set out in the *Notice*. The central problem with the AT&T proposal is the fact that inplace users of a considerable number of equipments and multi-line product categories would not have the option to purchase their equipment during the full duration of the transition period. Under the latest manifestation of the AT&T plan, in-place customers using multi-line CPE which is not offered for sale at the time of detariffing could have virtually no time at all to purchase their equipment

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Treatment (filed Oct. 7, 1983). Neither the Commission nor any staff of the Commission has reviewed, referred to, or relied upon any of this information in connection with the issuance of this Order.

[78] See para. 91 n.87, *infra*, for a listing of these categories of equipment.

[79] Various aspects of the approach we are establishing have received support in the comments. ICA, for example, contends that the embedded base should be transferred to ATTIS but that lease rates for all multi-line CPE should be frozen at existing state tariff levels until a more sufficient and detailed comprehensive sale program for multi-line equipment is submitted by AT&T and approved by the Commission, after an opportunity for public comment. ICA Direct Comments at 6; ICA Reply Comments at 7–8. We do not agree that *all* multi-line lease rates should be frozen at state tariff levels until a comprehensive sale plan is put forward by ATTIS. This would delay the transition to a fully deregulated CPE marketplace, and we conclude that no such delay is warranted with regard to multi-line CPE which AT&T is prepared to begin offering for sale immediately at the time of divestiture. Further, we reject the notion that a comprehensive sale plan (or sale plans for portions of the multi-line base offered for sale subsequent to divestiture) should be subject to public comment and to review and approval by the Commission. Such a mechanism would cause further delay; the mechanism is not necessary because this Order is a sufficient basis for ensuring that requirements will be in place which will result in sale plans which are consistent with our regulatory objectives. Allegations that these sale plans do not conform to the requirements established in this Order can be raised through the normal complaint procedures of the Commission. *See also* Ad Hoc Direct Comments at 10; Michigan Direct Comments at 3.

[80] We already have discussed our reasons for concluding that continued state tariffing is not appropriate. See paras. 41–44, *supra*.

before the end of the price predictability period applicable to their equipment.[81] The problem faced by these customers could be exacerbated under AT&T's proposal if their current state tariff lease rates are lower than ATTIS's national rates because they would begin moving toward the higher national rates at the time of divestiture.[82] This problem could cause significant user dislocations, contrary to our regulatory objectives, because many users would be confronted with the prospect of rising lease rates without having adequate information regarding the prices, terms, and conditions of sale for their equipment.[83]

88. Under the requirements we are establishing, all multi-line users will have a fair chance to decide whether to purchase their equipment before they become subject to lease rates which are within the sole discretion of ATTIS. These customers will not begin moving upward to higher ATTIS national lease rates until their equipment is actually offered for sale. Then, they will have a full two

[81] ICA had argued that, under AT&T's initial plan, some in-place multi-line customers might not have any opportunity to purchase their equipment during AT&T's proposed price predictability period because AT&T had committed itself merely to offer multi-line CPE for sale before the end of 1985, but AT&T's price predictability period would end on June 30, 1985. Thus, there was a six-month "gap" in the AT&T plan. ICA Direct Comments at 16–17. AT&T purports to close this "gap" by providing that, if a product category is not offered for sale by June 1, 1985, then the price predictability period for that category will be extended to the end of 1985. AT&T Reply Comments at 17 n.*. There are two problems with this solution to ICA's concerns. First, even if the product category were offered for sale on, say, July 2, 1985, users would have only six months (rather than 18 months) of price predictability while they considered their purchase options based on ATTIS's announced sale prices. Second, if the product category were offered for sale on, say, June 30, 1985, or December 31, 1985, then the period of price predictability during which purchase options could be considered would be reduced to *one day*.

[82] *But see* AT&T Direct Comments, Appendix B, at B2 n.** (price increases scheduled for January 1, 1984, may be deferred to March 1, 1984). See para.75 n.68, *supra*.

[83] The scope of this problem can be appreciated by considering the types of equipment which will not be offered for sale by ATTIS at the time of divestiture. These categories of equipment include a variety of manual and electronic PBXs, small dial PBXs, data sets, teletypewriters, and Centrex equipment. The primary example, however, is Key systems. Neither electromechanical nor electronic Com Key systems will be offered for sale at divestiture. It has been estimated that 2,613,000 stand-alone Key systems, and 13,067,000 instruments used with these systems, will be owned by the BOCs at the end of this year. (Stand-alone Key systems comprise approximately 55 percent of the Key system market.) NATA, *1982 Telecommunications Equipment Industry Statistical Review* 18 (1982). AT&T has indicated that ATTIS plans to begin selling 1A Key systems "behind" PBX or ESSX/Centrex switches in the fourth quarter of 1984, and that "Key-as-main" systems (the remainder of the 1A Key base) would be offered for sale not later than January 1, 1986. AT&T Direct Comments at 9–10. We conclude that this timetable is not adequate to ensure that Key system users have a fair opportunity to purchase their equipment while they are still protected by price predictability during the transition period.

years of price predictability in order to carry out their telecommunications planning and make purchasing decisions. We are convinced that this approach ensures a meaningful purchase option which satisfies our responsibility to comply with the equitable standards of *Democratic Central Committee*. Further, our requirements create an incentive for ATTIS to begin making sale offerings for multi-line equipment as soon as possible after divestiture, because the sale offerings will trigger the price predictability period, and ATTIS will be able to realize full pricing discretion only at the end of the price predictability period. AT&T's proposal has been criticized because it does not create any such incentives. *See* IDCMA Reply Comments at 11. This type of an incentive has obvious benefits for in-place customers because it increases the likelihood that ATTIS will advance the dates of initial sale offerings, thus ending the uncertainty which can frustrate user planning.

89. On balance, then, we have concluded that modifications are necessary in order to ensure that AT&T's sale and transfer plan for multi-line equipment meets the objectives we presented in the *Notice*. We are confident that the requirements we are establishing sufficiently meet these objectives without unduly or unfairly burdening AT&T. The following sections will present a more detailed discussion of the provisions of the multi-line CPE sale and lease plans.

B. *Duration of Sale and Lease Periods*

90. AT&T has proposed an 18-month price predictability period for embedded multi-line CPE, beginning on the date of transfer of the equipment to ATTIS.[84] In the *Notice*, we indicated that any extension of the transition period to four or five years would constitute an unnecessary continuation of regulatory restrictions. We also expressed the preliminary view that the difference in the length of the transition period for single-line and multi-line customers would not disadvantage business users. *Notice* at paras. 38–39. We invited comment on these issues. AT&T defends its proposal by arguing that the purpose of the price predictability period is to assist customer decision-making in the context of a detariffed environment, not to extend quasi-regulatory restrictions. AT&T Reply Comments at 16. AT&T argues that business users would have sufficient opportunity to make planning decisions regarding their CPE needs during the period proposed by AT&T, and that it would be burdensome to require ATTIS to commit itself to lease and sale prices for more than 18 months in the dynamic CPE market. *Id.* at

[84] *See* Notice at para. 38 n.33. AT&T also has indicated that, under its proposal, the price predictability program for particular product categories would be extended to January 1, 1986, if the product category has not been offered for sale by ATTIS by July 1, 1985. Monthly charges would remain at then-existing national levels. AT&T Reply Comments at 17 n.*.

15 n.** & 16–17. On the other hand, there is substantial consensus among the commenters that the transition period for multi-line CPE should be at least two years.[85]

91. Turning first to the date on which the transition period should begin, we conclude that the transition period for multi-line CPE should commence for a particular category of multi-line CPE at the time ATTIS notifies the customer involved in writing that it has initiated a sale program for that category of equipment.[86] Several factors have led us to this conclusion. Under AT&T's proposal, a significant portion of the embedded multi-line base would not be offered for sale at the time of divestiture.[87] As a result, a large

[85] Ad Hoc Direct Comments at 10 (at least two years from the time full information regarding sale and lease plans is made known); Ad Hoc Reply Comments at 3–4; ATAE Direct Comments at 5; Colorado Direct Comments at 2 (transition period of three to five years); CBEMA Reply Comments at 6–7 (at least two years); FEA Direct Comments at 16–18 (three to five years); FEA Reply Comments at 5 n.*; ICA Direct Comments at 21–25; ICA Reply Comments at 5 (at least two years from the time full information is available); Michigan Direct Comments at 4–5; NATA Reply Comments at 20; NATA Comments on AT&T Response to Bureau Letter at 5; North Dakota Direct Comments at 3; Tandy Direct Comments at 9; Virginia Direct Comments at 10. Only one commenter advanced the view that the price predictability period is unnecessary and should be eliminated. Centel Direct Comments at 5.

[86] ATTIS also shall file this written notice with the Commission. With regard to multi-line CPE which ATTIS intends to offer for sale at the time of divestiture, this notice should be made to customers as soon as possible after the release date of this Order. We also require that ATTIS furnish all multi-line customers with general information regarding ATTIS's sale and lease program during the transition period as soon as possible after such release date, including a statement that the customer may terminate lease service and obtain equipment from other vendors.

[87] AT&T has indicated that the following types of multi-line CPE would not be offered for sale at the time of divestiture under its proposal: Key telephone systems (electromechanical, 1A2 Key); SXS PBX, 700, 701, 702, 71, 740; electronic PBX, 800, 801, 805, 802; 812; XBar PBX, 757, 758, 770; manual PBXs (in accounts 231 and 234); general trade PBXs; Centrex CU; miscellaneous CPE in account 234, including Government special CPE, special assemblies, and DDS; small dial PBX, 750, 755, 756, 761; Com Key 1434, 734, 2152; miscellaneous business voice products; data sets, 400/600/800 series; Dataspeed 40/1, 2, 3; other data terminals; older teletypewriters, 28, 33, 35, 37, 38; radio CPE; Centrex consoles; data sets for networks; and emergency reporting systems. AT&T Response to Bureau Letter at Appendix E.

New York has raised a particular concern regarding 701 PBX switches used to provide Centrex CU service. Letter from David E. Blabey, Counsel, State of New York Department of Public Service, to Secretary, Federal Communications Commission (Oct. 14, 1983) (the letter has been included in the record of this docket). New York argues that subscribers to this service could face "potentially precipitous price increases" if the leasing of the 701 PBX switch were to be immediately deregulated. *Id.* at 1. Our reguirements will protect these subscribers by extending the transition period to two years and by providing that the transition will not begin until ATTIS offers the 701 PBX switch for sale to in-place customers. Further, we are establishing several multi-line lease rate requirements which will extend additional protection to these Centrex CU customers. *See* paras. 106–111, *infra.*

number of business customers would not be able to purchase their in-place equipment immediately and might not be given an opportunity to do so until as late as January 1, 1986. We conclude that we would not be fulfilling our responsibility to promote the public interest, convenience, and necessity under the Communications Act if we were to approve a sale plan which extends only a chimerical opportunity for purchasing equipment to a substantial number of in-place customers.

92. We indicated in the *Notice* that a "failure to offer a significant portion of embedded CPE for sale while it is under tariff, or shortly after it is detariffed, at a price which gives ratepayers an opportunity to realize any gain in the value of the CPE would pose significant problems under *Democratic Central Committee*." *Notice* at para. 33. A central aspect of our mechanism for satisfying the equitable principles of *Democratic Central Committee* is a sale plan under which in-place customers have a reasonable opportunity to decide whether to purchase their equipment at the offered price. If this opportunity to purchase is not a meaningful opportunity, then in-place customers would be deprived of their ability to realize gains in the value of their equipment above net book value because they would not have sufficient time to evaluate their choices. Under AT&T's proposal, we simply do not know how much time would be extended to users of a significant number of categories of multi-line equipment.[88] If a particular category of equipment is not offered for sale until near the end of AT&T's proposed price predictability period, users of that equipment will have only a short period of time to make decisions regarding whether to purchase before expiration of the period of stabilized lease rates for the equipment. After the end of the proposed price predictability period, these customers no longer will be protected by ATTIS's commitment to refrain from increasing lease rates. We conclude, therefore, that in-place customers must have the benefit of a definite, predictable period during which they are insulated from unpredictable and possibly substantial lease rate increases so that they can fully assess the options available to them.

93. We conclude that the transition period for multi-line equipment shall be two years. Contrary to our tentative finding in the *Notice* at para. 39, we find that the 18-month period of price

[88] AT&T has sought to assuage these concerns by assuring us that "it is estimated that roughly 75 percent of the multi-line CPE base will be made available for sale during 1984." AT&T Response to Bureau Letter at 13. It is our view, however, that it is not satisfactory to proceed in reliance upon such vague assurances. Even under AT&T's admittedly rough estimate, one-fourth of the embedded multi-line base might not be offered for sale until close to the end of AT&T's price predictability period, and a considerable portion would not be offered for sale until a full year after divestiture. The public interest requires us to fashion a sale plan for multi-line CPE which better protects the interests of in-place customers.

predictability for multi-line equipment is not adequate. For one thing, AT&T has not adequately justified disparate treatment for single-line and multi-line customers. For another, the comments demonstrate that the realities of business planning would make it difficult for many businesses to complete their decision-making processes regarding their CPE needs within an 18-month period.[89] This is particularly true because the exigencies of the present situation in most cases require businesses to evaluate their entire telecommunications systems for purposes of deciding whether to continue leasing from ATTIS, to purchase from ATTIS, or to switch to another vendor. The current task confronting business users is considerably more complex than the normal circumstance in which portions of CPE systems can be reviewed periodically on a staggered basis for purposes of determining whether replacement is warranted. We agree with AT&T that a primary objective of the transition period is assisting customer decision-making in a detariffed environment. The requirements we have established—a two-year transition period which will begin for each category of equipment at the time that equipment is first offered for sale—provide what we find to be the necessary level of assistance. Further, we are not convinced by AT&T's remonstrances that a six-month extension of the transition period for multi-line CPE will dramatically escalate the burdens faced by ATTIS. AT&T Reply Comments at 16–17. As we have described, AT&T in fact has agreed in its pleadings to make such an extension for certain types of equipment. Para. 87 n.81, *supra*. The flexibility we have granted to ATTIS with regard to its national lease rates[90] should offset any burdens resulting from a two-year transition period.

C. *Sale Plan*

94. We made clear in the *Notice* our view that a significant portion of the embedded base must be offered for sale while it is under tariff or shortly after detariffing in order to meet our regulatory goals and satisfy the requirements of *Democratic Central Committee*. *See, e.g., Notice* at para. 33. By ensuring that all in-place customers will have a full two years of price predictability during which to decide whether to purchase their equipment, we have established a sale plan which sufficiently protects the interests of

[89] *See, e.g.*, ICA Direct Comments at 21–25; Tandy Direct Comments at 9. FEA maintains that, because of the vagaries of the Federal budgetary process, it is unlikely that the Federal Government would be able to complete competitive bidding procedures for the replacement of its embedded base within a five-year period. FEA Direct Comments at 16–18. While we adhere to our view expressed in the Notice that a transition period of five years is not warranted, the concerns expressed by FEA demonstrate that something more than an 18-month transition is required.

[90] See paras. 106–111, *infra*.

these customers. Three related questions remain for examination. First, we must determine whether a sufficient portion of the multi-line base will be offered for sale by ATTIS. Second, we must examine the way in which sale prices will be derived for the multi-line base. Third, we must impose rules governing the establishment and application of monthly lease rates for multi-line CPE. These questions will be examined in this section and the following section.

1. *Scope of Sale Plan; Sale Procedures*

95. As we have discussed,[91] a sale program for the embedded base is necessary to ensure that ratepayers have a fair opportunity to realize any gain over net book value of the embedded assets. We recognized in the *Notice* that, without a sale program, the entity acquiring the embedded base would have the opportunity to sell the CPE for prices above net book value and capture the resulting gain. *Id.* at para. 31. We expressed the tentative view in the *Notice* that, if substantial portions of the embedded base were not offered for sale, it might be necessary to keep this CPE under state tariff or engage in valuation proceedings so that it could be transferred to unregulated service at some appraised value. *Id.* at para. 33. Concern also has been expressed in the comments regarding the portion of the embedded base which ATTIS will offer for sale.[92] Generally, AT&T's initial proposals in these proceedings were not adequate in meeting our desire that a significant portion of the multi-line base be offered for sale by ATTIS.

96. AT&T initially proposed that embedded multi-line CPE would be offered for sale to in-place customers only if the equipment was of a kind also offered for sale new by ATTIS, and that the purchase option would not be made available until the end of AT&T's proposed price predictabily period. AT&T Supplementary Comments, Oct. 28, 1982, at 21. AT&T later indicated its willingness to offer certain types of embedded CPE for sale at the time of detariffing, including Com Key 416/718, data terminals and modems, and certain miscellaneous equipment, such as 4A Speakerphones. AT&T Reply Comments, Dec. 3, 1982, at 26 & n.**. AT&T further amplified its proposal by indicating that embedded CPE which also is sold new by ATTIS "would be made available for purchase *at detariffing*." AT&T Further Supplementary Comments,

[91] See paras. 37, 55, 59–66, *supra*.

[92] *See, e.g.*, Ad Hoc Direct Comments at 6, 8; ATAE Direct Comments at 7 (type 557B cord boards should be covered); Darden Direct Comments at 3 (1A Key systems should be covered); FEA Direct Comments at 30 (special assembly equipment); ICA Direct Comments at 9 (all major product lines); NATA Direct Comments at 18 (1A Key systems); STC Direct Comments at 2–4 (1A Key systems); TCS and Valcom Direct Comments at 2–8 (1A Key systems); UTC Direct Comments at 2–3 (1A Key systems); Virginia Direct Comments at 4 (broadest range of CPE should be covered).

Mar. 29, 1983, at 12 (emphasis added). AT&T indicated that almost all categories 7 of embedded electromechanical CPE would be offered for sale by January 1, 1986, but pointed out that this would not include 1A Key equipment. *Id.* at 13 & n.*.

97. AT&T also set out in detail the factors which would influence the timing of sale offerings for electromechanical CPE. AT&T indicated that the following criteria would have to be met before a category of embedded electromechanical CPE would be offered for sale. First, there must be sufficient customer interest in purchasing the category of equipment to justify transaction costs which would be incurred in making the CPE available for purchase. Second, there must be reasonable assurance that an adequate supply of spare parts will be available to support the equipment for a reasonable period. Third, ATTIS must employ depreciation methods which enable it to establish sale prices which permit full capital recovery while also being attractive to in-place customers. Fourth, ATTIS must develop methods of informing customers regarding the advantages and disadvantages of purchase as opposed to monthly leasing: the customer must know the purchase price and the charge for maintenance support in order to make valid comparisons between purchasing and leasing; and ATTIS must be able to develop maintenance charges and terms to enable the customer to make informed choices. *Id.* at 13–16.[93]

98. In its most recent filings, AT&T has further modified its sale plan for multi-line equipment. Most significantly, AT&T has indicated that 1A Key equipment will be included in its sale program. AT&T Direct Comments at 7. AT&T discusses a variety of problems it perceives in connection with establishing sale programs for this equipment, and notes that it will begin to offer 1A Key systems "behind" PBXs for sale in the fourth quarter of 1984, with "Key-as-main" systems being offered no later than January 1, 1986. *Id.* at 8–10. AT&T now asserts that "every significant class of embedded CPE will be offered for sale." *Id.* at 11 (footnote omitted). In response to questions from the Bureau, AT&T has indicated that all significant classes of embedded multi-line CPE "will come under the terms of AT&T's national sales plan. . . ." AT&T Response to Bureau Letter at 4. AT&T also states that miscellaneous items and non-standard equipment[94] will be offered for sale on a case-by-case basis upon customer request. *Id.* at 4–5. Special assembly equipment will be

[93] The factors AT&T has indicated will be used to determine the timing of sale offerings are acceptable, and we shall not require that they be modified. We have established other requirements regarding the triggering and duration of the transition period for different categories of equipment which will give ATTIS an incentive to establish sale offerings as quickly as possible. See paras. 91–93, *supra*.

[94] AT&T gives as an example types of equipment which have been discontinued by AT&T but are still being provided by the BOCs. AT&T Response to Bureau Letter at 4 n.*.

available for purchase; ATTIS will provide a price quotation upon a customer's request and will guarantee that sale price for 90 days from the date of the quotation. *Id.* at 10–11.

99. We now are satisfied that under AT&T's modified plan *all* multi-line CPE will be available for purchase. We therefore accept the terms of the proposed plan, as modified. We have concluded, however, that several conditions should be imposed upon the multi-line sale plan. First, with regard to types of multi-line CPE which are not included in national sale plans, ATTIS shall notify in writing the users of this equipment that they have an opportunity to purchase the equipment and that ATTIS will work up a sale price quotation for them upon request. The two-year price predictability period with respect to these users shall begin on the date such notice is transmitted to them. Second, with regard to categories of equipment which are not offered for sale by ATTIS at the time of divestiture, we shall require ATTIS to furnish us with written notice not later than 10 days after any such category of equipment is initially offered for sale by ATTIS during the transition period. Third, we shall require ATTIS to file monthly reports with us during the transition period which include information regarding the level of sales of multi-line equipment, the revenue from these sales, and the relationship between this revenue and the adjusted net book value of the multi-line equipment which was transferred to ATTIS. This report should be included in the similar report we have required for single-line CPE. See para. 70, *supra.*

2. *Calculation of Sale Prices*

100. AT&T has indicated that it will apply the net book pricing standard in the aggregate to two categories of embedded equipment—single-line and multi-line CPE—and that the sale prices for multi-line CPE (as for single-line CPE) will equal, in the aggregate, net book value plus transaction costs. *See, e.g.*, AT&T Response to Bureau Letter at 8. We already have stated in this *Order* that this method of pricing is acceptable and that we find it unnecessary to modify AT&T's plan to require a further disaggregation of multi-line CPE categories or to impose other requirements with regard to sale prices. Part V.B.2., *supra.* A few commenters have raised concerns regarding the calculation of transaction costs by ATTIS in connection with the establishment of sale prices for multi-line CPE. They have suggested that the Commission should establish appropriate standards to ensure that transaction costs are not overstated. Others have suggested that ATTIS's transaction costs should be closely scrutinized by the Commission.[95]

101. AT&T has described a number of cost factors which may enter into transaction cost calculations: (1) Responding to inquiries

[95] *E.g.*, FEA Reply Comments at 7; Tandy Direct Comments at 10–11.

from customers and quoting sale prices to customers (including many customers who will decide not to purchase the equipment). (2) Carrying out physical inventories on customer premises if these inventories are necessary to establish price quotes. (3) Providing for procedures and prices for cases in which CPE is shared by two or more customers. (Equipment sharing often can be identified only by premises visits. It may be necessary to install redundant equipment to enable customers to purchase complete systems.) (4) Separating and physically tagging purchased CPE on customers' premises, to distinguish purchased from leased equipment. (5) Setting up a parts storage and distribution system to support maintenance, including the establishment of parts prices. (6) Producing documentation required by Part 68 of the Rules of the Commission to support maintenance of purchased products. (7) Establishing maintenance plans, contracts, and prices for purchased CPE. (8) Carrying out any necessary modifications to comply with national, state, or local codes and standards. AT&T Further Supplementary Comments, Mar. 29, 1983, at 13–15.

102. We have concluded that the factors which AT&T will take into account are not unreasonable, and that we have no basis for attempting to dictate any formula for establishing transaction costs on some gross basis which might overlook actual costs incurred by ATTIS in connection with its sale program. Because ATTIS faces competition in multi-line CPE, it has a built-in incentive to hold down transaction costs as a means of encouraging sales. This type of incentive is a better mechanism for ensuring reasonable transaction costs than any formula which might be devised through the regulatory process. We have concluded that the Commission can play a more effective role by monitoring transaction costs as they are established. We therefore shall require ATTIS to include in its notice to us regarding the inception of sale programs a detailed statement of transaction costs which will be imposed and the manner in which they were derived. With regard to multi-line CPE which will be offered for sale at the time of divestiture, ATTIS shall submit a report including this information not later than 30 days after divestiture. As we have already noted, we have sufficient authority to require modifications in transaction cost methodology if we find this to be necessary to serve the public interest. We will make every effort to ensure that transaction costs established by ATTIS are reasonable, and we will strive to dispose expeditiously of any complaints filed with us regarding ATTIS's transaction cost calculations or methodology.

103. Two matters relating to 1A Key systems also must be discussed. First, AT&T has pointed to a number of problems relating to the establishment of a viable sales program for 1A Key, and some of these problems have an impact on the level of transaction costs for 1A Key. A chief problem cited by AT&T is the fact that, because 1A

Key is not a clearly-defined product but rather is a congeries of components often made by different manufacturers and grouped into varying hardware assemblies, it will be difficult for ATTIS to work up price quotes for users who have expressed an interest in purchasing their equipment. AT&T Direct Comments at 8–9. "The complex and diverse nature of the equipment means that a large pre-sale effort, frequently including inspections by [ATTIS] technicians, will be required to identify a system's capabilities and arrive at a firm price quote." *Id.* at 9. We expect ATTIS to devise methods to reduce the high transaction costs associated with these efforts to establish price quotes. One means of doing this would be to charge customers who request price quotes the costs directly incurred in establishing the quotes. By charging the customer based on these costs even if the customer does not ultimately purchase the equipment, ATTIS would prevent these costs from being passed on (in the form of transaction costs) to other customers who do purchase their 1A Key systems. Those customers who do purchase after receiving a price quote could receive a credit for the cost of the quote, to be applied to the purchase price of the system. Although we stop short of imposing this method as a requirement, we encourage ATTIS to explore this approach, commonly used in other fields of commerce, in devising its 1A Key sale program.

104. Second, TCS and Valcom have argued that the pricing system proposed by AT&T for 1A Key systems is too complex and should be streamlined in order to hold down transaction costs. TCS and Valcom Reply Comments at 5. TCS and Valcom suggest that customer counts of equipment be permitted, with ATTIS having the option to conduct on-site verifications of these counts. *Id.* at 6–7. This would reduce the number of premises visits and thus would hold down transaction costs. We would encourage ATTIS to explore the possibility of adapting these suggestions made by TCS and Valcom as part of its effort to reduce transaction costs. We also intend to monitor the manner in which transaction costs are established for 1A Key systems to ensure that the level of these costs is not permitted to threaten the viability of the sales program.

D. *Monthly Lease Plan*

105. AT&T has proposed to establish national lease prices for all categories of multi-line CPE. *See, e.g.*, AT&T Direct Comments at 7.[96] If a particular customer is currently paying a monthly tariffed rate higher than AT&T's national lease rate, that customer will immediately be given a rate reduction to the national rate. AT&T proposes to bring customers currently paying less than the national rate up to

[96] It will be recalled that the monthly lease program for multi-line CPE proposed by AT&T also is intended to apply to single-line business CPE. Para. 75 n.67, *supra*; *see* AT&T Direct Comments at 6 n.*; AT&T Further Supplementary Comments, Mar. 29, 1983, at 10.

the national rate by establishing an initial minimum rate followed by three successive increases, with the final increase bringing the customer to the national rate. If a customer is currently paying less than the initial minimum, that customer will be immediately moved up to the initial minimum and then will be taken up to the national price in three stages. If the customer is currently paying more than the initial minimum but less than the national price, that customer will initially remain at the customer's current lease rate and then will be moved up to the national rate in three or fewer stages, depending upon the level of the customer's current lease rate. *See* AT&T Reply Comments, Dec. 3, 1982, at 24–26. AT&T also proposes to use the highest state tariffed rate "in effect or filed on March 29, 1983" as the ceiling for national lease rates.[97]

106. Except as modified herein, we accept AT&T's proposal. Our modifications reflect our findings above that the transition period should begin at the time a category of CPE is offered for sale and that the transition period should be two years. We also address AT&T's proposed lease rate ceiling. First, customers currently paying more than the national rate will immediately be moved down to the national rate and will remain at that rate until the end of the two-year price predictability period applicable to those customers. Second, customers currently paying less than the initial minimum established by AT&T for the category of equipment involved will be moved up to the initial minimum at the time of detariffing, if that category of equipment is being offered for sale by ATTIS at the time of diverstiture. Customers currently paying less than the national initial minimum and using any category of equipment which is *not* offered for sale at the time of divestiture will continue paying lease rates in amounts equal to those in their previously applicable state tariffs in effect on December 31, 1983, until this equipment is initially offered for sale by ATTIS. After this initial sale offering has been made, these customers will be moved up to the initial national minimum at the time of the initial sale offering, and will be moved up to the national lease rate in three stages of equal rate increases occurring eight months[98] apart (with the last stage thus occurring at the end of the two-year price predictability period). Third, customers currently paying more than the initial minimum but less than the

[97] AT&T Direct Comments, Appendix B, at B4. March 29, 1983, is the date on which AT&T submitted its proposal regarding multi-line lease rates to the Commission. It is not clear whether AT&T has abandoned its suggestion that the highest state tariff *on file* should be eligible for use as a ceiling for national rates, since AT&T has recently defended its proposed use of the highest state rate by arguing that "at least one state commission has found the rate to be just and reasonable." AT&T Response to Bureau Letter at 23. In any event, our requirements regarding this calculation shall control. *See* para. 75 n.69, *supra*; para. 108, *infra*.

[98] Under AT&T's proposal, the three stages of rate increases would have occurred six months apart. We have decided to retain the three-stage approach, adding two months to each stage.

national lease rate will remain at their current rate level until their category of equipment is initially offered for sale by ATTIS. After this initial sale offering, these customers will be moved up to the national lease rate in three or fewer stages occurring eight months apart during the transition period.[99] It will be noted that these requirements essentially adopt the approach proposed by AT&T, with regard to which virtually no opposition is expressed in the comments.[100]

107. With regard to the ceiling for national lease rates, AT&T argues that a more restrictive formula than the one it proposes "is not justified in the context of a competitive CPE marketplace." AT&T Response to Bureau Letter at 23. AT&T also notes that there has been "little rate activity" since announcement of the MFJ, that ratepayers are amply protected by the proposed price ceiling, that ATTIS needs some measure of flexibility in establishing national lease rates, and that basing the ceiling on existing state tariffs or some average of those tariffs would be unreasonable, if not confiscatory. *Id.* at 23–24. Only a few other commenters have addressed this issue. FEA objects to use of the highest state tariff rate as a ceiling

[99] The price increases at each stage will be in equal amounts. The point at which a particular customer becomes subject to these increases will depend upon the relationship between that customer's current lease rate and the level of the national lease rate established by ATTIS. *See* AT&T Reply Comments, Dec. 3, 1982, Chart 1, at 25.

[100] FEA has proposed that the shift from current lease rates to AT&T's national lease rates be carried out on a one-step, "clean cut" basis because "the gradual price adjustment process would be extremely disruptive to Government acquisition entities and [ATTIS]." FEA Direct Comments at 23. Although there may be some merit to FEA's concerns, we conclude that its argument does not justify requiring AT&T to abandon its phased-in lease rate approach, taking notice of the fact that gradual price increases—as opposed to one initial lump-sum increase—would appear to be an attractive alternative to most business customers. If the Federal Government wishes to pay more than otherwise would be the case, it should be free to do so and we do not foreclose these arrangements. Other customers, however, should remain protected.

AT&T apparently does not intend to establish national lease rates for special assembly equipment. AT&T has indicated that "it is not possible to derive a national sales price for [special assembly] equipment", and has gone on to point out that "[m]onthly charges for special assemblies will not be increased" during the transition period. AT&T Response to Bureau Letter at 11. Although AT&T does not so indicate specifically, we conclude that its reasoning regarding the difficulty of establishing national sale prices for special assembly equipment also applies to establishing national lease rates for this equipment. Given this fact, we require that the lease program for special assemblies shall be as follows: Special assembly customers shall continue to pay their current lease rates during the transition period applicable to their equipment, except to the extent to which AT&T is able to establish national lease rates for any components comprising a special assembly configuration. This transition period shall be two years in duration and shall begin on the date ATTIS notifies these customers that they may purchase their equipment. *See* para. 99, *supra*. The lease rates for these customers may not be increased by ATTIS until the end of the applicable transition period.

because "[t]his could result in the selection of higher lease rates for older equipment to encourage migration to new [ATTIS] alternatives." FEA Direct Comments at 21. ICA argues that the proposed ceiling is unsatisfactory because the differential between the highest state tariff rate and other rates currently in effect is too great. ICA Direct Comments at 9–20. NATA contends that AT&T has failed to defend adequately its rationale for the proposed ceiling, that AT&T has not provided data regarding the extent of recent rate activity, that state-by-state lease rates may be more appropriate in the context of the continued leasing of the embedded multi-line base, and that AT&T's proposed ceiling may not necessarily be an appropriate hedge against increased costs. NATA Comments on AT&T Response to Bureau Letter at 15–18.

108. We shall require that the ceiling for national lease rates for any category of multi-line equipment of a type not also leased as new equipment by ATTIS (as of December 31, 1983) not exceed the higher of (1) an amount equal to 70 percent of the highest state tariff in effect for that category of equipment on March 29, 1983; and (2) the statistical median of all state tariffs in effect on that date for that category of equipment. We accept AT&T's proposed ceiling for categories of embedded multi-line CPE which are also leased as new equipment by ATTIS. We have concluded that this approach will give a measure of protection to in-place customers in states with low tariffed rates while also giving ATTIS considerable flexibility in establishing its national lease rates. Our concern with use of the highest state tariff as the ceiling for equipment which is not also leased as new equipment by ATTIS is that competition has not had sufficient opportunity to establish a reasonable level for lease rates for this equipment. In these circumstances, we conclude that use of the highest state tariff as a ceiling would extend too much flexibility to ATTIS. In contrast, for those product lines which are also leased as new equipment by ATTIS, the marketplace has set reasonable lease rate levels; ATTIS has been leasing this CPE on a competitive basis for nearly a year.

109. By applying the 70 percent ceiling to embedded multi-line CPE which is not also leased as new equipment by ATTIS, we are providing that a broad range of multi-line equipment will be subject to this ceiling, including Key systems, certain electronic PBXs, and manual PBXs. While the 70 percent mark does not allow AT&T as much as it desires, in most states it will represent an increase, but not one so large as to threaten rate shock in any area. Further, there is no evidence in the record that AT&T will not be able to recover its costs under this 70 percent ceiling. A ceiling set at 70 percent of the highest state tariff seems to us to be a reasonable solution in light of the wide variation in state rates and the extraordinary difficulty and expense involved in gathering enough data to support any particular ceiling. A sampling of lease rates for 1A Key systems (a category of

multi-line CPE which ATTIS does not lease as new equipment) provides an example of the problem we are addressing. The current tariff in Maryland (a state with relatively low tariffs for 1A Key systems) for a system with two lines and six stations is $32.04. The highest state tariff (in New Mexico) for this system is $87.65. Thus, if the highest state tariff were used as the ceiling, users in Maryland could face an increase of 174 percent over two years in their rates for this 1A Key configuration. The current tariff in New Jersey (another state with relatively low tariffs for 1A Key systems) for a system with 10 lines and 20 stations is $162.03. The highest state tariff (in Rhode Island) for this system is $337.50. Thus, New Jersey users could be subject to a rate increase of 108 percent over two years if the highest state tariff were used as the ceiling.

110. The fact that AT&T has indicated that it should not be assumed that ATTIS's national lease rates will be set as high as the ceiling offers another potential protection against these drastic lease rate increases. We have given considerable thought to AT&T's representations, and we believe that AT&T would have every incentive not to raise its lease rates above reasonable levels. It is evident that, in establishing national lease rates, some higher and some lower than current rates, AT&T intends to implement a program which is easily administered and which will return enough total revenue to cover nationwide total costs for the equipment under lease. Dramatic increases in lease rates are likely to alienate customers, driving them to competing vendors. As a business proposition, AT&T would hardly risk alienating potential long-term purchasers of new equipment and services for the relatively small profits available from excessively high lease rates charged during the transition period. By the same token, we are confident that the reduced ceiling we are establishing for a portion of the multi-line base will not unduly restrict ATTIS's pricing flexibility. To the extent there is any basis for AT&T's concern that ATTIS could be burdened by the two-year freeze on its lease rates during the transition period, we have offset this burden by extending to AT&T a degree of flexibility regarding the initial establishment of these rates.

111. These requirements are designed to afford in-place customers sufficient time to pursue alternatives if they choose not to retain ATTIS's equipment because of any increases in lease rates. We do not believe the public interest is harmed in any way by permitting ATTIS the type of flexibility in deriving lease rates which we are authorizing here. This is particularly true because the marketplace will serve as a check upon any attempt by ATTIS to impose drastic increases in current lease rates. To the extent any such attempt is made, in-place customers will be able to seek alternatives from other vendors. The requirements we have established regarding the duration of the transition period and the phasing-in of lease rates

during that period ensure that real alternatives will exist in the marketplace as the transition period progresses. For all these reasons, we find that the concerns expressed in the comments are not sufficient to warrant restrictions beyond those which we are establishing here.

E. *Other Issues*

112. AT&T states that ATTIS will provide a 90-day warranty in connection with the sale of embedded multi-line CPE. The coverage of this warranty will be equivalent to that provided to ATTIS customers for new equipment under so-called "conversion to purchase" arrangements. AT&T Response to Bureau Letter at 13. AT&T also states that the same financing opportunities that ATTIS makes available to new CPE customers will be provided in connection with embedded CPE sales. Some terms and conditions for embedded CPE may differ from those applicable to new CPE reflecting the fact that embedded CPE is used equipment. Nevertheless, claims AT&T, the criteria for developing terms and conditions will be the same as for the new CPE. *Id.* at 14.[101] We find that these terms and conditions are not inconsistent with the purposes of the transition to a fully detariffed CPE environment. Accordingly, they are acceptable.

VIII. SUPPORT OF EMBEDDED CPE DURING TRANSITION PERIOD

A. *BOC Billing and Related Support Services*

113. AT&T states that during an interim period of up to 18 months following the detariffing and transfer of embedded CPE, ATTIS will be unable immediately to create completely separate billing and service order processing systems and to have completed the conversion of BOC CPE accounts for use by ATTIS systems. AT&T Direct Comments at 66–70. Accordingly, ATTIS will need to contract with divested BOCs for certain CPE-related Customer Record Information Systems (CRIS) functions, some service order processing and the collection of undisputed customer bills. At the time of the embedded CPE transfer, ATTIS will have established its own business offices for equipment order and service order negotiations. To perform these functions, the business offices will have access to customer equipment records located in the BOC CRIS data base. Completed service orders will be forwarded from ATTIS systems to the BOC service order processing systems for updating of the CRIS files. Using their CRIS systems, the BOCs will perform

[101] Conversion to purchase arrangements are transactions whereby credit toward an eventual purchase of lease equipment is accumulated over the duration of the lease. AT&T Response to Bureau Letter at 15–16. Also note that with the modifications prescribed in Part VI.D., *supra*, all warranties offered under the transition plan will be of 90 days duration.

billing and related recordkeeping for ATTIS embedded CPE. The BOCs will also provide ATTIS with revenue journals, tax reports, and embedded CPE revenue, movement, and in-service quantities for use in ATTIS's financial and management systems.

114. Parties' comments argue that: (1) the BOCs should not be permitted to provide these support services to ATTIS; (2) AT&T has not proposed adequate compensation of the BOCs for the provision of proposed services; (3) AT&T's plans for the protection of customer-specific information proprietary to the BOCs are inadequate; (4) AT&T should be required to compensate the BOCs for the value of the information that ATTIS will be able to use competitively; (5) the BOCs' embedded CPE bills rendered on behalf of ATTIS should include certain informational statements; and (6) BOC-provided CPE billing services should be provided to all CPE vendors on a non-discriminatory basis. Each of these arguments is discussed in turn.

1. *Need for BOC Support Services*

115. In comments filed February 28, 1983, numerous parties had opposed BOC provision of the proposed services.[102] Parties calling for a ban on the provision of these services based their position largely on two arguments: first, *Second Computer Inquiry* prohibits joint billing and, second, ATTIS should not be permitted to control the embedded CPE base until it is prepared to shoulder that responsibility independently. *See, e.g.*, IDCMA Capitalization Comments at 23.

116. *Second Computer Inquiry* prohibits joint billing by the separate subsidiary and "affiliate carriers." *Further Reconsideration*, 88 FCC 2d at 530. Assuming for the purpose of resolving this issue that the rule refers solely to affiliation by ownership, the *Second Computer Inquiry* rules do not apply to the great bulk of interim support services proposed by AT&T. These services will be provided following divestiture. Therefore, there is no need to address here whether the BOCs should be prohibited from providing billing and support services to ATTIS prior to divestiture.[103] As to ATTIS operations conducted after January 1, 1984, we will not bar BOC

[102] Embedded CPE Capitalization Comments of IDCMA at 21–25; NATA Comments at 17–20; Tandy Comments at 18–19; New York Comments at 26. These February 28 comments were directed to AT&T's Embedded CPE Capitalization Plan filed January 21, 1983. Parties subsequently did not restate their opposition to provision of these services in their comments filed in response to the Notice in this docket. From this silence, AT&T infers parties' acquiescence to AT&T's assertion of the need for the proposed support services. AT&T Reply Comments at 61. We will not draw that inference but will rule on the merits of arguments raised by the parties in their February 28 filings.

[103] Prior to divestiture, however, Northwestern Bell provided billing and related support to ATTIS's embedded CPE operations in Iowa during June 1983 through October 1983. Notice of Apparent Liability for Forfeiture, File No. ENF 83–36, FCC 83–514 (released Nov. 17, 1983). Although Northwestern Bell provided this support without obtaining Commission authority, this apparent noncompliance

provision of billing and related services. There is a significant danger that substantial billing and other service disruptions could result if the BOCs were unable to provide billing and related support to ATTIS on a transitional basis. Provision of this transitional support is essential to implement the public interest in achieving an early detariffing and transfer of AT&T embedded CPE. Contingent on AT&T's adoption of the modifications discussed below, we approve the BOCs' provision of billing and related services commencing January 1, 1984, at transfer of the embedded base to ATTIS and ending no later than June 30, 1985.

2. *Compensation of BOCs for Support Services*

117. In the *Notice*, we invited comments regarding whether we should adopt any requirements concerning compensation of the BOCs for the support services which they will provide. *Notice* at para. 44. We specifically referred to our determination in the access charge proceeding that rate-of-return methods should not constrain the amounts that exchange carriers may earn for provision of billing services to interexchange carriers. *MTS and WATS Market Structure*. CC Docket No. 78–72, Phase I, Third Report and Order, FCC 82–579, 48 Fed. Reg. 10319, at para. 251 (released Feb. 28, 1983), *appeal docketed sub nom. NARUC v. FCC*, No. 83–1225 (D.C. Cir., Mar. 1, 1983) (hereinafter *MTS and WATS Market Structure*). AT&T responded to the *Notice* by stating that *United States* v. *AT&T* required that charges for the multi-function facilities used in the provision of billing and related services are to be cost based.[104] According to AT&T, there is, consequently, no need for the Commission to prescribe a compensation method. AT&T Direct Comments at 76. AT&T's competitors disagree among themselves concerning the appropriate compensation method. NATA believes that compensation should not be constrained by rate-of-return methods, while Tandy believes that billing must be done on a strict cost plus reasonable profit basis. NATA Direct Comments at 22 n.*; Tandy Direct Comments at 14.

118. We decline to require a compensation methodology different from that required by the District Court's approval of the AT&T Plan of Reorganization. Only the BOCs can provide these interim services to ATTIS on a timely and efficient basis. Thus, for purposes of effecting this transition, the BOCs are in the position of monopoly providers. The cost of providing monopoly services is the most

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with the requirements of Second Computer Inquiry is being addressed in another proceeding. *Id.* Moreover, ATTIS now conducts its own billing and related services in Iowa.

[104] These costs are: "(a) investment costs (depreciation, taxes, lessor's cost of capital); (b) primary costs (direct labor, departmental line supervision, departmental expenses, staff support, operating rents); (c) general overhead costs . . . and (d) a float charge." AT&T Direct Comments at 76 *quoting from* AT&T Plan of Reorganization at 107, United States v. AT&T (filed Dec. 16, 1982).

reasonable basis for determining the charges for such services. *See, e.g., Private Line Cases*, 34 FCC 244, 297 (1961), and the BOCs are already required to use a cost basis under the MFJ.

3. *Treatment of Customer Proprietary Information*

119. The *Notice* raised the possibility that all customer-specific embedded CPE information to which ATTIS has access should be disclosed to all vendors. *Notice* at paras. 45–49. Without such disclosure, the *Notice* suggested, ATTIS may obtain exclusive control of information pertaining not only to the embedded CPE it provides, but also to information on access line services provided to all BOC customers including those using equipment obtained from independent providers. This may afford ATTIS an unfair competitive advantage over other CPE providers which do not have similar access to BOC customer data.

120. AT&T proposes that ATTIS personnel have access to three categories of customer-specific information: (1) general customer information (*e.g.*, customer name, billing address, billed telephone number, business or residence, class of service); (2) embedded CPE-specific information (*e.g.*, equipment types, based on Universal Service Order Codes, quantities, equipment location); (3) non-CPE service information (*e.g.*, access line, toll usage, and directory advertising). AT&T Direct Comments at 70–71. AT&T argues that upon transfer of the embedded base to ATTIS it is solely the third category of data—basic service proprietary data—to which ATTIS access must be restricted. AT&T proposes that, where possible, the BOCs will mask this information or render it mechanically inaccessible by ATTIS. Where this is not possible, access within ATTIS will be limited to those business office personnel who have a need-to-know in order to complete the processing of an order which will have been obtained by the marketing department or will be placed directly with these business office personnel by customers who spontaneously seek CPE service independent of engagement by ATTIS's marketing personnel. These business office personnel with need-to-know access include service representatives, order writers, and their supervisors in the ATTIS business offices. According to AT&T, marketing personnel will not be given access to basic service information. Business office personnel will be trained, closely supervised, and warned of disciplinary action (including dismissal) concerning requirements of non-disclosure of basic service proprietary data. With these safeguards, argues AT&T, ATTIS will be unable to gain competitive advantage from its access to BOC proprietary basic service data. *Id.* at 72. AT&T argues against automatic disclosure to competitors of any of the data contained in any of the three categories of customer information. As to the first two, AT&T commits to provide to the customer, upon written customer request, copies of billing detail and customer equipment records from files or

mechanized sources "that are reasonably available." *Id.* at 74; *see also* AT&T Reply Comments at 65. The customer could then disclose this information to any vendor or vendors the customer chooses.

121. Most parties do not take issue with AT&T's proposed treatment of customer information. California agrees that customers should be given the option of disclosing information pertaining to their service but urges that if the customer does not state a preference, the information should be disclosed to all vendors on a non-discriminatory basis. California Direct Comments at 10. User groups favor reservation of discretion to the customer for the reason that information about the customer's communication service may provide the customer's competitors with useful insights or it may impart security information about the customer's business. *See, e.g.*, UTC Direct Comments at 3–4; ICA Reply Comments at 16. One association of AT&T's competitors believes that lists containing only embedded CPE customers' names and addresses should be available for purchase by all interested parties at fair market value. IDCMA Direct Comments at 17–18; IDCMA Reply Comments at 23. NATA goes further and argues that not only are the masking and other protective mechanisms for the third category of information inadequate, but that, under the philosophy of *Second Computer Inquiry*, ATTIS is no more entitled to the first two categories of information than is any other interconnect company. NATA Reply Comments at 31–34. Thus, according to NATA, the embedded base should be offered only under tariff by an EBO which, limited by its frozen equipment base, would have no incentive to take competitive advantage of any of the three categories of customer information. NATA Direct Comments at 20–21.

122. As indicated in the *Notice*, we regard the scope of ATTIS's access to customer information and the scope of its customer information disclosure obligations as interdependent. Ideally, ATTIS would have no access to regulated service proprietary information and, accordingly, no obligation to disclose. Failing that, AT&T has proposed a reasonable compromise which we discuss below. Our analysis of the proposed treatment of customer information must distinguish between, on the one hand, CPE-related information (*i.e.*, that information referred to by AT&T as general customer information and CPE-specific information) and, on the other hand, basic service-related information. Concerning ATTIS's access to CPE-related customer information, we find that this sort of information is essential to the provision of embedded CPE. It would be unreasonable to permit transfe of embedded CPE equipment to ATTIS but deprive it of the information necessary for it to operate the embedded base business. Embedded CPE and general customer information are attributes of the embedded base, the transfer of which we approve in this *Order*. Perforce, we approve the "transfer" to ATTIS of CPE-related customer-specific information.

123. Concerning basic service-related customer information, we find that the BOCs' interim provision of billing and related support services, which we have found essential (*see* Part VIII.A.1., *supra*), unavoidably entails access by certain ATTIS non-marketing personnel to that information. We further find that AT&T's proposed mechanism for ensuring that ATTIS marketing personnel are unable to obtain similar access, standing alone, is inadequate fully to reassure us that ATTIS cannot possibly obtain any competitive advantage from its access to that information. AT&T's efforts to control internal dissemination of basic service information entail employee instruction and threat of disciplinary action, including dismissal. These are reasonable efforts to enforce internal information flow controls. However, they are inadequate to control casual and inadvertent employee behavior and, thus, are inadequate to guarantee that ATTIS can obtain no competitive advantage from access to basic service-related customer information.[105]

124. Despite this difficulty, we accept AT&T's plan.[106] We do so, first, because we discern no other practical option that will assure a smooth and timely transition with less potential anticompetitive impact. Second, AT&T proposes a mechanism which, properly implemented, can help mitigate any anticompetitive advantage which may have flowed from ATTIS's access to regulated customer

[105] Second Computer Inquiry structural separation requirements demonstrate the importance that we have attached to assuring that regulated communications service information does not become accessible to unregulated communications service operations on a preferential basis. Part of the reason that the separate subsidiary must conduct its operations in separate facilities is to assure that information flow prohibitions are not undermined by inadvertent or casual communications among employees of regulated and unregulated operations. *See* Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide New Customer Premises Equipment, Phase I, 91 FCC 2d 578, 609 (1982); Reconsideration Order, 84 FCC 2d at 81.

[106] In September 1983, the Common Carrier Bureau granted AT&T an interim waiver of Second Computer Inquiry structural separation requirements to permit access to customer data prior to January 1, 1984, in order to begin conversion of BOC and Long Lines customer records to ATTIS systems. *See* Request for Waiver of Section 64.702(d)(3) of the Commission's Rules and Regulations, File No. ENF 83–38 (released Sept. 2, 1983) (Customer Information Waiver). The interim waiver was expressly temporary and conditioned on further Commission action. In its waiver request, AT&T had stated that it would take steps to assure that none of ATTIS's access in 1983 to any of the three categories of customer information would be used by ATTIS for marketing purposes. AT&T's description of steps taken concerning BOC and Long Lines data is the same as the description in this Order of the steps taken concerning basic service data. In this proceeding we have approved the proposed protective procedures for access line data. For the same reasons that we approve ATTIS's customer data access on and after January 1, 1984, we approve ATTIS's customer data access prior to January 1, 1984. Accordingly, we extend approval of the Bureau's September 2, 1983, waiver of Second Computer Inquiry structural separation conditions until December 31, 1983, and terminate the waiver proceeding (File No. ENF 83–38).

information. AT&T's proposal is intended to permit each individual embedded base customer to decide whether and to whom information specific to that customer's service and equipment should be disseminated. This will promote competition in the CPE market to the extent it assures that AT&T's control of the embedded base cannot be used to impede embedded CPE customers' efforts to obtain prompt and informed price quotes from alternative providers. Not only will this measured facilitation of competition help reduce any anticompetitive advantage which may follow from ATTIS's regulated information access, it will also assure protection of the customer's interest in confidentiality. Moreover, voluntary customer dissemination of CPE-related information is consistent with *Second Computer Inquiry* precedent. *Cf.* Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide New CPE, Phase II, FCC 83–123, Appendix A, at paras. 37–38 (released Apr. 13, 1983) (written customer authorization required for disclosure of customer-specific information by a BOC to ATTIS).

125. We find that, in general, AT&T's proposal to provide customers with equipment information upon written notice is reasonable. We require, however, certain clarifications of AT&T's implementation plans in order to assure the efficacy of AT&T's customer information program. The first such clarification is suggested by California's proposal described at para. 121, *supra*. While AT&T states that it will respond to written customer requests for equipment information, it does not describe the means by which customers will be notified of the opportunity to submit such a request. AT&T should provide each embedded customer with a conspicuous, clear, and full written explanation that the Commission has required AT&T to provide the customer with all CPE-related information necessary or useful for facilitating the customer's opportunity to seek alternative providers of CPE.[107]

126. All embedded CPE customers should be informed of this opportunity with their first formal written notice of the price predictability program after the release date of this *Order*. See para. 91 n.86, *supra*. All customers whose equipment is not offered for sale immediately upon commencement of the price predictability program should be informed again of this opportunity at the same time that the customer's equipment is first offered for sale. AT&T's responses to customer requests should be sufficiently prompt that customers' planning efforts are not impeded. In addition, AT&T should include in its monthly report to the Bureau steps that it has

[107] AT&T's notification of single-line customers should include a statement that the customer is entitled to buy or continue to lease the AT&T-provided equipment but the customer may also terminate lease service and obtain equipment from other vendors. For most single-line customers, this may be all the information that is necessary or useful for facilitating the customer's opportunity to seek alternative providers.

taken concerning the implementation of this customer information dissemination program. *See* paras. 70, 99, *supra*.[108]

127 The second clarification is suggested by ICA's argument that the user should be entitled to receive without any charges a copy of all billing information. ICA Reply Comments at 18. AT&T proposes to recover "reasonable costs" associated with providing this information to the customer. AT&T Direct Comments at 75. In the interest of assuring that the customer is not discouraged from obtaining the CPE-related information, the "reasonable" charges which AT&T may assess should be limited to recovery of the incremental costs of the provision of this information to the customer.

128. Third, AT&T states that it will provide to customers information which is reasonably available, and that AT&T should not be required to create any materials which are not in existence or which are not available in the ordinary course of business. AT&T Direct Comments at 74. AT&T, however, should not be permitted to escape the obligation of fully responding to a customer's information request on the ground that information controlled by ATTIS must be collated or edited into a new document in order to be communicated to the customer. Rather, AT&T should respond to customer requests by providing all pertinent information which ordinarily would be used by an equipment vendor in planning the design of and charges for a proposed communications system for the customer. AT&T has argued that the BOC's general customer information and the embedded CPE-specific information are essential for adequate customer service.[109] AT&T Direct Comments at 71. Accordingly, we cannot see why any of this information may be withheld from disclosure to customers.

4. *Compensation of BOCs for Value of Customer Information*

129. Another issue raised by parties' comments concerns compensation paid by ATTIS to the BOCs for the value of the CPE-

[108] The report should include a model customer notification. It should state the numbers of customers to whom the notification has been sent. These customers should be identified by class of equipment used. The dates on which the notifications were communicated and the form in which they were communicated should be stated. AT&T should also state, by the same customer classifications, the numbers of customers who have requested and received CPE-related information. AT&T should identify in detail, by customer classification, the type of CPE-related information that it has sent in response to customer request.

[109] Examples of the customer information for which AT&T requested conversion to ATTIS systems include the customer's name, billing address, and telephone number, type and quantity of CPE, rate formerly billed by the BOC or Long Lines, Standard Industrial Classification Code for the customer, summary billing codes for customers who request consolidated billing, tax information, and account servicing information, including credit history, special contracts, and engineering diagrams for special assembly CPE. *See* Customer Information Waiver, File No. ENF 83–38, at para. 2.

related information. IDCMA argues that ATTIS should be required to purchase at fair market value any customer-specific information that is transferred. According to IDCMA, this would assure that the ratepayers obtain the value of customer lists transferred to ATTIS and prevent ATTIS from obtaining an unfair competitive advantage. IDCMA Direct Comments at 17–18.

130. There is no ground to require compensation of the BOCs by ATTIS for the transferred customer information. As we found in Part VIII.A.1., *supra*, the customer information is an integral part of the embedded CPE business that will be transferred to ATTIS. As such, the value of the information is reflected in the value of the embedded base assets that will be transferred to ATTIS. We have found in Part V.B. 1., *supra*, that, in the absence of any feasible alternative, the value of the transferred assets should be stated on the companies' books as reductions in asset account amounts equal to the book value of the transferred embedded base. Thus, any "compensation" due to the BOCs for the transferred information is reflected in the reductions of the net book values stated in their asset accounts. This will not constitute an unfair competitive advantage to ATTIS. To the extent that adjusted net book value serves as a surrogate for fair market value of the embedded base, including the information integral to that base, ATTIS will "pay" no more nor less than would another "buyer" of the embedded business.

5. *Billing Information*

131. A fifth matter is raised by New Jersey's objection that the BOCs' provision of CPE billing would give customers a false sense of regulatory protection which they will not be receiving. New Jersey Direct Comments at 4. AT&T responds that the CPE portion of the customer's bill will include the following legend:

> This portion of your bill is provided as a service to AT&T Information Systems. There is no connection between [the BOC's name] and AT&T Information Systems. You may choose another company for your customer premises equipment while still receiving your local telephone service from [the BOC's name].

Numerous parties endorse the need for such a notice. *See, e.g.*, California Direct Comments at 9; Michigan Direct Comments at 5; Kentucky Direct Comments at 2; NATA Direct Comments at 22; Tandy Direct Comments at 6. Centel believes that such notice would be superfluous. Centel Direct Comments at 6. We believe that a notice at least as informative as that proposed by AT&T should be prominently displayed in the CPE bills prepared on behalf of ATTIS.

In addition, the notice should state that the BOC may not terminate service for nonpayment of ATTIS CPE charges.[110]

6. *Availability of Billing Services to Other Vendors*

132. As a sixth matter, some parties argue that BOC provision of billing and related services will afford ATTIS a competitive advantage. They urge that we require the BOCs to provide to other vendors the same services as they will extend to AT&T. Kentucky Direct Comments at 2; Virginia Direct Comments at 8; Tandy Direct Comments at 14. Parties in effect request that we require the BOCs to enter a particular line of business, the business of bill collection. We will not embark upon requiring a communications common carrier to undertake this non-communications enterprise.[111] Rather, we will rely on less dramatic means of limiting any competitive advantage that may follow from the BOCs' provision of billing and related support services to ATTIS. To the extent that competitive advantage takes the form of a higher collection rate than achieved by CPE providers unassisted by an implicit threat of the cut-off of a BOC's basic service, any such advantage will be mitigated by the terms of the customer billing notice that we have prescribed. *See* Part VIII.A.5., *supra*. In addition, we will require that any partial payment shall be applied first against charges for transmission service.[112] This prioritization should be plainly stated on the customer notice. To the extent that ATTIS's "good will" may be heightened by a perceived association between the BOCs' business, which is regulated in the public interest, and AT&T's unregulated competitive enterprise, the notice that we have required should substantially dispel such advantage. If any remaining competitive advantage follows from ATTIS's receipt of billing and related support by the BOCs, such advantage should not endure long beyond the June 30, 1985, termination of these services. Such advantage, if any, would appear at this time to be too small to warrant any Commission action beyond that which we have already prescribed.

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[110] We are concerned that "customer premises equipment" may be a term of art not readily understood by the consumer. We expect that the language of the bill's legend will state its intended message in plain language.

[111] The MFJ excludes the BOCs from the provision of any product or service, except exchange telecommunications and exchange access service, that is not a natural monoply service actually regulated by tariff. MFJ, Section II.D.3. A Commission requirement that the BOCs engage in an activity which may be prohibited by the MFJ would create confusion and delay which would probably extend beyond the termination date of the BOCs' provision of the interim services.

[112] We have similarly conditioned any provision of billing services by the divested BOCs' regulated entity on behalf of its unregulated organizational unit's residential and single-line business operations. *See* Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services, CC Dkt. No. 83–115, Report and Order, FCC 83–552 (adopted Nov. 23, 1983).

B. *Maintenance and Related Support of Embedded CPE by ATTIS*

133. In this section we determine whether AT&T's plans for the maintenance and related support of embedded CPE following its detariffing and transfer are consistent with the purposes of the detariffing transition plan prescribed by this *Order*. A purpose of the transition plan is to assure that AT&T's embedded base customers will have full opportunity to assess their equipment needs and to select the provider best able to meet those needs. As discussed in Part VII.A. through VII.C., *supra*, we believe that the terms of AT&T's price predictability period, as modified, provide adequate assurance that the customer will be afforded the necessary financial repose in which to make these determinations. If AT&T, however, fails to provide maintenance support sufficient to assure the usefulness of the customer's equipment during the price predictability period, the repose provided by AT&T's price assurances can be undermined. Also, the usefulness to a customer of installed equipment can be undermined by failure of support for moves, rearrangements, or growth.

134. An additional purpose of the prescribed detariffing transition plan is to assure that an offer for sale of in-place equipment will afford ratepayers the opportunity to obtain any gains on regulated equipment and to assure the broadest possible customer choice as AT&T's installed base is introduced into the untariffed marketplace. AT&T's sale program, however, can be undermined if the equipment offered for purchase will not receive sufficient support to be useful over a period long enough to justify the costs of purchase. Again, the support necessary for such assurance includes maintenance, moves, rearrangements, and growth.[113] If potential in-place buyers lack any of these assurances, the ratepayer may be deprived of the opportunity to obtain any gains in the value of the embedded base in conflict with the equitable principles of *Democratic Central Committee*.

135. Several parties urge that we bar during the price predictability period any termination of product support. FEA Direct Comments at 28–29; IDCMA Direct Comments at 23–24; *see also* Colorado Direct Comments at 4; New Jersey Direct Comments at 3; NATA Direct Comments at 16. In addition, parties seek to blunt the consequences of any AT&T termination of product support by barring AT&T from restricting intermixture of AT&T equipment with independently provided equipment. STC Direct Comments at 5; NATA Direct Comments at 16; TCS and Valcom Reply Comments at 12–13.

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[113] Reference to "maintenance" or "support" of embedded CPE hereinafter will comprehend all levels of support for continued usefulness to a customer of embedded CPE, including that for maintenance and repair, moves, rearrangements, changes, and growth.

136. AT&T states that it will offer maintenance support for all CPE offered for sale. AT&T Response to Bureau Letter at 14. AT&T, however, will offer no such support for equipment offered near the end of the price predictability period as to which a prior notice of discontinuance will have been issued. *Id.* For the types of embedded equipment also sold new by ATTIS, maintenance contracts will be available on the same terms and conditions of service as those applicable to new CPE. As to all other types of embedded CPE offered for sale, maintenance contracts will be offered only where it is feasible to derive a reasonable monthly maintenance charge. Maintenance will be available only on a time and materials basis for non-standard or older vintage equipment for which technical specifications are unavailable or for which there is insufficient demand to establish a maintenance plan. *Id.* at 15. As to lease equipment, AT&T states that it will continue to provide maintenance to all customers with existing agreements for at least 18 months following January 1, 1984. *Id.* at 19. The maintenance service will be the same as that provided to ATTIS's new CPE customers and will be provided at comparable charges. *Id.*

137. Also, AT&T seeks to reserve the discretion to terminate the maintenance support for a product when replacement parts are no longer available or when these parts can be procured only at inordinate cost. *Id.* at 20. This "phase-out" may happen if a manufacturer discontinues a product, if it raises the unit price to counter low sales volumes, if cannibalized parts from equipment removed from service are no longer sufficient for maintenance needs, or if the quantity of equipment in service is no longer sufficiently great to justify the cost of a maintenance force. AT&T would provide no less than one year's notice of any phase-out except when compelled by circumstances beyond AT&T's control. *Id.* at 22. Because AT&T believes that its proposed arrangements for the maintenance support of embedded CPE are adequate, it has made no plans to make available to customers or other providers the parts, specifications, or licenses of relevant technology. *Id.* at 15, 22.

138. In sum, AT&T reserves for itself substantial discretion in determining the scope of its maintenance support offerings. A key example of such discretion is AT&T's proposed determination of which equipment will be supported by maintenance contracts under terms and conditions similar to those for new CPE, on the one hand, and, on the other hand, which equipment will be supported on a time and materials basis. The principal basis for this distinction is AT&T's judgment of the sufficiency of customer demand, a highly flexible standard. Moreover, AT&T provides no indication of how it will assure that time and materials charges will not be so high as to deprive prematurely the customer of the usefulness of that equipment. Of even greater potential consequence is AT&T's reservation of judgment on which products may be phased out. This determina-

tion turns largely on AT&T's judgment of profitability, again, a highly flexible standard. Moreover, AT&T can alter its stated decisional factors, namely the availability and prices of parts and products provided by other manufacturers. This is true because AT&T has been such a large customer of these manufacturers. *Cf.*, *e.g.*, Tone Commander Systems, Inc., Petition for Waiver (ENF 83–23), filed Mar. 23, 1983 (petitioner may go out of business as a result of AT&T's termination of the purchase of parts for 1A2 Key systems).

139. Despite the breadth of discretion which AT&T seeks to reserve for itself, we do not find the proposal contrary to the public interest. A goal of detariffing is to permit AT&T, along with its competitors and customers, the opportunity to make exactly the sort of economic judgments described by AT&T. However, as stated above, the goal of the prescribed transition period is to afford AT&T's embedded CPE customer an interim period of stability in which to make informed decisions concerning telephone equipment needs. Rather than burdening AT&T with the responsibility to provide support regardless of profitability, we will simply require that if, at any time during the prescribed transition period, AT&T decides to phase out a product, it should take steps necessary to assure that customers can obtain the terminated support from other sources.

140. Specifically, AT&T should not undertake any product phase-out on less than one year's notice. Such notice should be delivered in writing to all customers served by the phased-out equipment. No later than the date of the announcement of product phase-out, AT&T should make available all technical information and rights necessary for the support of the phased-out product. AT&T may charge reasonable, compensatory rates for such information and rights. The notice to the customer should indicate the availability of pertinent technology and rights. If circumstances beyond AT&T's control require notice of less than one year, AT&T should report to the Common Carrier Bureau, no later than the announcement of the phase-out, on its plans for the discontinuance of support. The report should identify the product(s) scheduled for phase-out, the date of phase-out, the numbers of installed systems affected, and the circumstances which required less than one year's notice of phase-out.

141. By itself, the availability of requisite technology is insufficient to assure the continued usefulness to a customer of a phased-out product. Independently provided spare parts cannot be installed if restrictions prevent attachment of the parts to phased-out products. Evidently recognizing this, AT&T "commits that ATTIS will make available equipment-to-equipment interconnection capability equivalent to that now offered under tariff, at least until 1A key systems are offered for sale." AT&T Direct Comments at 11. We

approve that commitment with the following clarifications. Tone Commander and Valcom argue that certain improper BOC practices permit only those equipment-to-equipment interconnections that can be made with certain standard-type connectors. TCS and Valcom Reply Comments at 12. To assure that AT&T does not incorporate into its transition plan any allegedly unwarranted restrictive BOC practices, AT&T should not prevent equipment-to-equipment interconnection between its embedded CPE and other manufacturers' components and adjunct devices registered under Part 68 of the Commission's Rules and Regulations, and it shall work cooperatively with such manufacturers to facilitate this interconnection.

142. We believe that these measures will assure that AT&T can legitimately protect its own economic self-interest without sacrificing protection of its existing customers. The ready availability of the technology necessary for independently provided support of phased-out equipment will assure that a decision of the market, not that of a single entity, will determine whether continued support of the equipment is economically efficient and hence beneficial to the public interest.

IX. TAX ISSUES

143. In the *Notice* we asked for comments on whether deferred tax reserves and unamortized investment tax credits ("ITCs") associated with embedded CPE should be transferred from the BOCs to ATTIS together with that CPE. We also expressed our tentative conclusions that the deferred tax reserves should be transferred to ATTIS but that the unamortized ITCs should remain with the BOCs and be credited to their income tax expense at the time the associated CPE is removed from the regulated accounts. *Notice* at paras. 52–59. The principal reason for the proposed difference in treatment was that the deferred tax reserves represent future tax liabilities associated with the CPE (resulting from the prior use of accelerated methods of depreciation for tax purposes) that AT&T, not the BOCs, will have to pay, and, therefore, AT&T should have the reserves on its books against which to charge these future payments. ITCs, on the other hand, represent permanent tax savings that were realized under regulation; therefore, the *Notice* suggested, it would be more equitable to return those savings to ratepayers by requiring the BOCs to retain the unamortized credits and use them to reduce their tax expenses for ratemaking purposes. Based on a review of the comments submitted on these questions and our own further analysis of the issues involved, we affirm our tentative conclusion that the transfer of deferred tax reserves to ATTIS, as proposed in the *Notice*, is proper and should go forward. However, that review and further analysis have convinced us that it would not be proper for the unamortized ITCs to remain with the BOCs after the associated assets have been removed. Accordingly, we direct that

those accounts also be transferred to ATTIS together with the associated CPE.[114]

144. Our decision to require the transfer of both the deferred tax reserves and unamortized ITCs with the associated embedded CPE derives from the nature and function of those tax-related accounts, as reflected in the relevant statutory provisions and their legislative histories, and applicable accounting rules and principles. We conclude that such a transfer would be consistent with the intent of Congress in providing for the tax benefits of accelerated depreciation and investment credits for regulated utilities and with underlying accounting standards. Furthermore, we conclude that the transfer of those accounts would not work an inequity on ratepayers (the concern raised in the *Notice* with respect to ITCs), nor bestow unfair competitive advantages on ATTIS in the CPE marketplace. On the other hand, there is a substantial risk that retention of those accounts by the BOCs (to be used to reduce rates after the associated assets have been removed from the regulated books) would violate the requirements of the Internal Revenue Code (the "Code") with serious adverse tax consequences for the BOCs, resulting in financial burdens for those companies and their ratepayers. We explain the bases for these conclusions in detail in Appendix A and provide a summary of that explanation below.

145. Under the Code certain regulated utilities, including the BOCs, are entitled to use accelerated methods of depreciation and ITCs only if the resulting tax benefits are "normalized" for ratemaking purposes.[115] With respect to accelerated depreciation, normalization is achieved by treating the utility's income tax expense (which is included in the utility's cost of service) not as the amount it actually paid in taxes, but as the amount it would have paid had it used its book (typically, straight-line) method of depreciation to determine its income tax liability. The difference between the taxes the utility

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[114] AT&T has proposed that the transfer of these accounts from the BOCs to ATTIS be accomplished by adjusting downward the net book value of the embedded CPE in the amount of the balances in these accounts. We find that this adjustment to the transfer price of the CPE is an acceptable mechanism for effecting the transfer of the accounts, and we authorize that it be made. It is our understanding, however, that the transferred assets will be carried on ATTIS's books at net book value (without those adjustments) and that the deferred tax reserve and unamortized ITC accounts will be maintained as separate accounts on those books. If AT&T proposes a different treatment of these accounts, we direct that it inform us of that proposal prior to its imlementation.

[115] I.R.C. §§ 46(f) (ITCs), 167(1) (accelerated depreciation). The Commission's rules provide for such normalized accounting for both types of tax benefits. *See* Sections 31.3–32 (accelerated depreciation) and 31.174, 31.304 (ITCs) of the Commission's Rules. For financial reporting by nonregulated companies, generally accepted accounting principles require normalized treatment of accelerated depreciation, *see* AICPA Accounting Principles Board, Opinion No. 11, and recommend such treatment of ITCs, *see* AICPA Accounting Principles Board, Opinions No. 2 and No. 4.

actually pays and the tax expense it shows on its regulated books is credited to a deferred tax account or reserve. At any given time, this reserve represents the accumulation of tax reductions that have resulted from the excess of accelerated depreciation over straight-line or other book depreciation over the years. These accumulated tax reductions represent cost-free capital to the utility. While it will eventually have to repay those funds to the Treasury in the form of higher taxes,[116] it has the interest-free use of those funds until that repayment occurs. For this reason, the Code permits deferred tax reserves to be deducted from a utility's rate base, and we require utilities under our jurisdiction to make that rate base adjustment.

146. With respect to ITCs, normalization is achieved by amortizing the credits over the life of the property that gave rise to them rather than treating the credits as reductions in tax expense in the year in which they are received. In this fashion, the tax benefits of the ITCs are flowed through to ratepayers, but only at the same rate that the associated assets are depreciated. The amount of the ITCs not immediately recognized for ratemaking purposes as a reduction in tax expense is credited to an unamortized ITC account, which at any given time represents the accumulated ITCs taken by the utility on its tax returns but not yet flowed through to ratepayers.

147. We now agree with a number of the commenters that under the normalization approach to accounting for the tax benefits of both accelerated depreciation and ITCs, as provided in the Code, our rules, and generally accepted accounting principles, there is a direct and continuing relationship between the assets that give rise to those benefits and the resulting deferred tax reserve and unamortized ITC accounts.[117] Under normalization those accounts come into being as a result of the taxpayer's investment in those assets and are used to reduce the costs associated with providing service with those assets over their useful lives. It follows, in our view, that as a general proposition deferred tax reserves and unamortized ITC accounts should ordinarily not be separated from the underlying assets. However, some commenters have suggested, in effect, that the transfer of embedded CPE from the BOCs to ATTIS is not an ordinary event and that certain considerations, particularly the fact that the transfer will be from a regulated to an unregulated entity,

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[116] These higher taxes result from the fact that under accelerated depreciation, the larger deductions in the early part of an asset's life are offset by smaller deductions in the latter part of its life. Hence, accelerated depreciation results in a tax deferral, not a permanent tax savings.

[117] *See* AT&T Reply Comments at 41–50; Arthur Andersen Direct Comments at 2–4; SNET Direct Comments at 18–21; GTE Direct Comments at 35–38.

render it inappropriate in this case for the deferred tax reserves and unamortized ITC accounts to move with the associated assets.[118] Indeed, it was such a concern that underlay our tentative view that since the ITCs arose under regulation, they should remain under regulation and be flowed through to ratepayers even after the associated CPE has been removed from regulation.

148. There appear to be three principal sets of concerns raised in the *Notice* and the comments on the question whether deferred tax and unamortized ITC accounts should be transferred with the embedded CPE.

(1) Would a transfer of those accounts be equitable for ratepayers of the BOCs?

(2) Would retention of those accounts by the BOCs for continued use in ratemaking violate the applicable provisions of the Internal Revenue Code and result in the BOCs forfeiting their eligibility for accelerated depreciation and investment credits?

(3) Would transfer of those accounts confer unfair competitive advantages on ATTIS in the CPE marketplace?

149. With respect to the first concern, whether BOC ratepayers would be equitably treated by the transfer of these accounts depends to a large extent on whether deferred taxes and ITCs are properly regarded as "loans" or "overpayments" from ratepayers to utilities (in which case ratepayers would have an equitable claim for repayment)[119] or "loans" or "grants" from the United States Treasury, the benefit of which ratepayers and utilities share in a manner provided by Congress (but with respect to which ratepayers have no particular equitable claim).[120] With respect to both types of tax benefits, either of these characterizations could conceivably apply. But in each case only the second characterization appears to be consistent with Congress' view of what it was doing in making accelerated depreciation and investment credits available to regulated public utilities and with the particular requirements it imposed on utilities and regulatory commissions for handling the resulting tax benefits in the ratemaking process. Indeed, the substance and history of the relevant provisions of the Code reflect a Congressional resistance to any regulatory treatment of those tax benefits that would be consistent with their characterization as ratepayer-supplied funds.[121] Thus, it appears that transfer of those accounts with

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[118] *See, e.g.*, NATA Direct Comments at 29–39; NATA Reply Comments at 39–50; California Direct Comments at 10–19; CBEMA Direct Comments at 5–6; CBEMA Reply Comments at 7–8.

[119] This is the characterization advanced by the opponents of transfer of the accounts. *See, e.g.*, NATA Direct Comments at 30–32; CBEMA Direct Comments at 5; California Direct Comments at 17; Tennessee Direct Comments at 6.

[120] This is the characterization advanced by the proponents of transfer of the accounts. *See, e.g.*, AT&T Reply Comments at 46–50; Arthur Andersen Direct Comments at 3.

the associated CPE would neither be inconsistent with Congressional intent in providing these tax benefits for utilities and their ratepayers, nor result in ratepayers losing the right to recover anything to which they have an equitable claim.

150. With respect to the second concern of possible violations of the Code,[122] it does seem likely that leaving the deferred tax reserves and unamortized ITC accounts with the BOCs (so that they could be used by regulatory commissions to lower BOC rates) after the associated CPE has been transferred would not be consistent with the requirements of the Code or the associated Department of Treasury regulations governing the use of accelerated depreciation and ITCs by public utilities. Those requirements seem to assume a continuing relationship between, and a series of complementary adjustments to, a utility's deferred tax reserves and unamortized ITC accounts, on the one hand, and its depreciation expense, tax expense, and rate base, on the other. And the mechanisms provided in the Code for passing on the tax benefits of both accelerated depreciation and ITCs to ratepayers are so closely connected with the regulatory depreciation process that it seems highly unlikely that those benefits could continue to be passed on after the depreciation of the associated assets has ceased. Thus, the basic incompatibility of the relevant provisions of the Code and regulations with a situation in which the investment in, and depreciation of, the CPE is severed from the associated deferred tax and unamortized ITC accounts suggests that those provisions would be violated, and the BOCs' eligibility for accelerated depreciation and ITCs placed in jeopardy, if the BOCs were to retain those accounts.

151. With respect to the third concern of possible advantages for

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[121] Far from viewing the normalization requirements of the Code as a means of extracting "loans" or "overpayments" from ratepayers, Congress viewed those provisions as a means of permitting ratepayers to share in the benefits that it—Congress—had made available to utilities. As noted, this sharing is accomplished with respect to accelerated depreciation by the exclusion of the deferred tax reserves from utility rate bases and with respect to ITCs by the flow-through of the tax savings to ratepayers at the same rate that the assets are depreciated. In neither case does Congress appear to have contemplated that ratepayers would continue to receive these benefits after the associated assets are removed from regulation and the costs of the assets are no longer being borne by ratepayers. For a further discussion of Congressional intent on these issues, see Appendix A at paras. 7–15, 23–27, & 32–36.

[122] This concern is raised by AT&T and other commenters. *See* AT&T Direct Comments at 42–44; AT&T Reply Comments at 47–49; Arthur Andersen Direct Comments at 2; Centel Direct Comments at 9; GTE Direct Comments at 38; SNET Direct Comments at 20–21. Other commenters reject this as a serious concern. *See* NATA Reply Comments at 41–44; California Direct Comments at 18–19.

ATTIS in the CPE marketplace, the commenters advancing this argument[123] do not make a convincing case that the transfer of these accounts would place other providers of CPE at a serious disadvantage in competing with ATTIS. The transfer of the accounts would not involve a transfer of any funds from the BOCs to ATTIS that could be invested or used to finance or subsidize any of ATTIS's operations; nor would it reduce any future tax liabilities of ATTIS or otherwise affect that company's cash flow. If the deferred tax reserves are transferred, ATTIS will be able to account on its books for the deferred taxes it will pay (as the result of the BOCs having consumed much of the tax basis of the CPE through accelerated depreciation deductions) by charging them against these reserves rather than against current income. If the unamortized ITCs are transferred, ATTIS will be able to charge some of its tax expenses, including those attributable to any recapture of the ITCs that occurs as the result of sales of CPE prior to the requisite holding periods, against that account rather than against income. AT&T argues that ATTIS's competitors will be able to account for their deferred taxes and ITCs in exactly these ways on their books. And, in our view, these appear to be proper uses of the deferred tax and unamortized ITC accounts. Thus, while the earnings and operating results ATTIS will be able to report on its financial statements will be better if those accounts are transferred than if they are not, it does not appear that these reporting and accounting factors will bestow an unfair advantage on ATTIS vis-a-vis other CPE firms or enable ATTIS to engage in anticompetitive pricing or other business conduct with which this Commission might be concerned. At least the commenters do not persuasively identify any such possibility.[124]

152. In sum, the major objections to transferring the deferred tax reserves and unamortized ITCs from the BOCs to ATTIS—that such transfers would be inequitable to ratepayers of the BOCs and would disadvantage competitors of ATTIS—do not appear to be substantial. Conversely, leaving the reserves or the unamortized credits with the BOCs does appear to raise a serious risk of violation of the Code with resulting adverse tax consequences for the BOCs.

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[123] *See* CBEMA Direct Comments at 5–6; CBEMA Reply Comments at 8; NATA Direct Comments at 32–39; NATA Reply Comments at 49; California Direct Comments at 17–18.

[124] Indeed, to the extent these accounts are capable of conferring competitive advantages or disadvantages, AT&T's arguments that it would be disadvantaged in relation to its competitors if the accounts are not transferred seem at least as cogent. In particular, since AT&T will be responsible for paying the deferred taxes and recaptured investment credits associated with the transferred CPE, it would seem a disadvantage (and somewhat inequitable) for it not to have the corresponding deferred tax reserves and unamortized ITCs to account for those liabilities. *See* AT&T Reply Comments at 43-45; *see also* Arthur Andersen Direct Comments at 3–$; SNET Direct Comments at 18–21; GTE Direct Comments at 35–37.

Accordingly, we conclude that the most appropriate course for us to take for with respect to these accounts is to provide for their transfer to ATTIS together with the associated embedded CPE.[125]

X. ACCOUNTING ISSUES

A. *Supporting Assets*

153. The *Notice* proposed that land and buildings which are supporting assets being transferred to ATTIS from the BOCs should be transferred at appraised value. It also proposed certain accounting changes to ensure that the gains resulting from appreciation of land flowed to the ratepayers. This approach was consistent with the findings in *Charges for Interstate Services*, Docket No. 19129, wherein we concluded that land and buildings are assets which generally appreciate in value and that the ratepayers should receive the benefits resulting from this appreciation. In that decision, however, we noted that the accounting[126] in place at that time for the sale of land produced benefits for the stockholders, contrary to judicial precedents indicating that those benefits should go to the ratepayers who have borne a financial burden related to these assets. *Democratic Central Committee*, 485 F.2d at 806, 808–16. The comments received from state commissions relative to the proposed transfer of land and buildings at appraised value are generally favorable.[127] AT&T, however, agrees to the transfer at appraised value only if all supporting assets, not limited to land and buildings,

[125] AT&T also has proposed that deferred income tax on Western Electric profits should be restored. AT&T Comments, June 4, 1982, at 24. AT&T has described its proposed treatment of these deferred taxes in the embedded CPE base capitalization plan proceeding before this Commission. *See* AT&T Capitalization Reply at 9–12, AT&T Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide Embedded CPE, File No. ENF 83–18 (filed Mar. 15, 1983). AT&T notes that, under its proposed treatment, "[t]he BOC, which previously was 'restoring' (paying) the tax to the IRS, will be relieved of that responsibility . . . and Western Electric will assume this liability. [ATTIS] will be the recipient of property with an adjusted net book value . . . higher than the BOC has." *Id.* at 11. We agree with AT&T that the BOCs are not harmed by this proposed treatment, and note that no commenter has challenged the resulting upward adjustment in net book value of the transferred assets. Accordingly, we conclude that AT&T shall be authorized to carry out the restoral of deferred taxes on Western Electric profits in the manner proposed in this proceeding.

[126] The Uniform System of Accounts provides for the gain or loss on the sale of land to be recorded to account 360, "Extraordinary income credits," or account 370, "Extraordinary income charges." Both are below the line accounts which normally benefit the stockholders. In this instance, however, we find that gains from the sale of land entered in account 360 should be passed on to ratepayers. *See* para. 154, *infra*.

[127] California Direct Comments at 19–20; Colorado Direct Comments at 6; Idaho Direct Comments at 3; Kentucky Direct Comments at 3–4; New York Direct Comments at 8; Virginia Direct Comments at 7. NATA also supports the transfer at appraised value. NATA Direct Comments at 40.

are transferred at appraised value. Other supporting assets include motor vehicles, computers, furniture, fixtures, and machinery.

154. We conclude that land and buildings should be transferred to ATTIS at appraised value,[128] as we proposed in the *Notice*, for the following reasons. First, land and buildings are assets which are normally appraised when they are transferred or sold because their appreciated value can be reasonably and readily determined. Second, this approach recognizes the fact, as indicated in *Charges for Interstate Service*, Docket No. 19129, that ratepayers have borne a financial burden for land and buildings and should benefit from their appreciation. We will not provide, however, that other supporting assets be transferred at appraised value and shall require instead that these supporting assets be transferred at net book value. The varied and extensive nature of these assets makes it likely that any attempt to appraise them would fail to be accurate and would introduce uncertainty and delay into the detariffing process.

155. We proposed certain accounting changes in the *Notice* to ensure that ratepayers receive the benefit of any such gains.[129] Upon review, however, we find that accounting changes are not necessary to ensure that the benefit from gains in the value of land does flow to ratepayers or to recognize the unusual nature of this particular occurrence. Also, we see no benefit of using the extraordinary retirement and maintenance accounting suggested by several parties. Even though this transfer is an unusual occurrence, the estimated $15 million in gains involved is not material enough to warrant the extraordinary accounting treatment. Instead, we have concluded that the prescribed accounting for the sale of land should be followed by recording the gain as a credit to account 360, "Extraordinary income credits." At the same time, however, we have

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[128] We are referring to the appraised value established under the Commission's interagency agreement with the United States Army Corps of Engineers. AT&T agreed to contract with an independent appraisal firm to determine the fair market value of land and buildings which will be transferred to its nonregulated operations. The Commission has signed an interagency agreement with the Corps of Engineers to review these appraisals. After this review, the appraisals will be used to establish the value at which AT&T must transfer the land and buildings to its nonregulated operations. AT&T contract appraisers have completed their appraisals and the results have been submitted to the Corps of Engineers for review.

[129] Five parties agree with the approach we suggested in the Notice. Colorado Direct Comments at 6; Kentucky Direct Comments at 3; Michigan Direct Comments at 6; NATA Direct Comments at 41; Virginia Direct Comments at 7. Two commenters argue for continuation of the current accounting for land wherein the net gain or loss is recorded in account 360, "Extraordinary income credits," or account 370, "Extraordinary income charges," since the stockholders should benefit. Centel Direct Comments at 6; Ameritech Direct Comments at 5. AT&T also argues that accounts 360 and 370 should be used since they reflect the extraordinary and nonrecurring nature of the situation. AT&T Direct Comments at 32.

concluded that such gains belong to the ratepayers and should be so treated in rate proceedings. This approach adequately reflects the extraordinary nature of the transactions, and at the same time protects the interests of the BOCs and ratepayers.

156. In a related matter, the *Notice* proposed that the BOCs and ATTIS share the cost of appraisals of land and buildings, and that the BOCs record these costs in account 675, "Other expenses." There is no consensus among the parties that the appraisal costs should be borne jointly by the BOCs and ATTIS. AT&T argues that the BOCs should bear the total cost since the appraisals are in response to regulatory requirements and are intended to protect the BOC ratepayers. AT&T Direct Comments at 30. Other commenters argue that the costs of appraisals should be charged to ATTIS since ATTIS will keep the assets. Colorado Direct Comments at 6; Virginia Direct Comments at 7. Finally, Michigan contends that ATTIS, as a buyer, should bear these appraisal costs as is normal real estate practice. Michigan Direct Comments at 6–7. As to the proper account, AT&T agrees with the use of account 675. AT&T Direct Comments at 30. Michigan, though opposing the BOCs' paying for appraisals, argues that, if we do charge these costs to the BOCs, account 675 is not appropriate since this approach would flow 100 percent of the costs to the ratepayers. Michigan Direct Comments at 6–7.

157. We find that there should be no sharing of land and buildings appraisal costs between the BOCs and ATTIS, and that the costs of appraisals should be charged to account 675 on the BOCs' books pending transfer of the assets to ATTIS. At that time, these costs should be transferred to account 360 in the case of land and to the depreciation reserve in the case of buildings to offset the gain. Though we were initially not prepared to place the entire burden of the cost of all appraisals undertaken by AT&T on ratepayers, we have altered our position because for those areas where we have encouraged appraisals, we agree with AT&T that it is equitable for ratepayers to incur the costs since the appraisals are the result of a regulatory action and were incurred to protect the interests of ratepayers.[130]

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[130] Based on information provided by AT&T, it is estimated that this cost approximates $1 million, representing the appraisal of land and buildings. AT&T also estimates, however, that an additional $2 million could be incurred in appraising leasehold improvements and all other supporting assets, although AT&T has indicated that these appraisals have not been conducted. Since we did not instruct or encourage AT&T to conduct these appraisals and since we are requiring these other supporting assets to be transferred at net book value, there does not appear to be any reason to conduct these appraisals. If any such costs are incurred, however, we require them to be borne by AT&T shareholders.

Two other points regarding accounting treatment should be mentioned. First, although account 139, "Other deferred charges," on the BOCs' books may be used on an interim basis in order to continue to reflect only the original costs of the plant in the plant accounts, no balance should remain in account 139 on the BOCs' books

B. *Accounting for Proceeds of CPE Sold Under Regulation*

158. Under our current accounting rules the proceeds realized from the sale of embedded CPE are treated as gross salvage and credited to the depreciation reserve, a plant account. Similarly, the rules state that the transaction costs associated with the sale of embedded CPE are to be treated as cost of removal which requires the cost to be charged to the depreciation reserve. In the past, these accounting procedures would ensure that gains or losses from the sale of embedded CPE would be passed on to ratepayers over the remaining life of the depreciable assets.

159. The *Notice* indicated that these existing accounting procedures could create problems in connection with the removal of embedded CPE from regulated service. Many BOCs and Independent companies[131] are now offering some embedded CPE for sale at state-tariffed rates which may exceed net book value plus transaction costs. Our current accounting rules would apply these gains from sale of embedded CPE to the depreciation reserve and thereby lower the net book value of the remaining CPE in the accounts. The carriers' investors would receive the benefit of the gains through the transfer of embedded CPE at a lower net book value. The *Notice* questioned the propriety of this accounting since only selected types and quantities of CPE were being offered for sale. As an alternative to our current accounting, the *Notice* solicited comments on whether we should credit the difference between the sale price and the net book value to revenues and charge transaction costs to operating expenses, both of which are current operating accounts. This change to our existing accounting would ensure that ratepayers would realize any gains, or absorb any losses, from the individual sales of embedded CPE.

160. Several commenters disagree with the Commission's proposed alternative and recommend that the current salvage accounting be maintained. SNET, for example, states that the Commission's proposal of using current operating revenue and expense accounts has an undesirable effect of increasing the company's net income, creating an illusion of growth without a corresponding true economic activity. SNET also argues that the process of tracking each sale

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after the transfer of the plant to ATTIS. Second, we will not permit an accounting treatment under which the appraised value of assets transferred to ATTIS is reduced by the appraisal costs and the charge for appraisal costs also remains in the BOCs' account 675, "Other expenses." This approach would have a doubling effect on the BOCs by charging them the cost of appraisals and also reducing their receipts by the same amount, and is therefore unacceptable.

[131] Our decision today addresses only CPE sold by the BOCs. We will address CPE sales under regulation by the Independents in a subsequent action in this docket. *See* para. 175, *infra*.

would be a costly process which can be avoided by using salvage accounting.[132] AT&T states that the sales proceeds are a recovery of capital and should be treated in accordance with traditional retirement accounting. To do otherwise would improperly divert the recovered capital to ratepayers. AT&T Direct Comments at 33–36; AT&T Reply Comments at 33–40. California believes that extraordinary retirement accounting would satisfy the Commission's concern by allowing the gains to be amortized to income over a fixed period. This would give the state regulatory commissions the flexibility to ensure that such gains are reflected in the BOCs' revenue requirements for regulated operations. California Direct Comments at 22–24.

161. A number of commenters support the alternative of using current operating accounts.[133] NATA believes that the rules should be revised to eliminate the potential distortion in the value assigned to the embedded CPE which will ultimately be transferred to ATTIS, arguing that the current accounting rules would preclude ratepayers from receiving benefits to which they are entitled from the sales of embedded CPE. NATA Direct Comments at 41–42; NATA Reply Comments at 50. Some commenters simply state that they do not believe that the carriers' investors should receive benefits from the gains realized from the sale of embedded CPE. Minnesota Reply Comments at 3; Colorado Direct Comments at 6; Michigan Direct Comments at 7; Virginia Direct Comments at 7; Wisconsin Direct Comments at 6.

162. After reviewing the comments, we are now persuaded that our existing accounting rules are sufficient, and therefore, we are not adopting the alternative accounting we originally proposed. The major intent in our proposal was to protect the interests of the individual ratepayers, particularly since the various sales programs included only selective CPE. However, since AT&T has extended its sales program to include additional CPE, and since the individually tariffed state programs have been designed to protect ratepayers in the past, our concern in this area is diminished. Furthermore, all sales programs will allow ratepayers to make their own decisions as to whether the CPE is priced properly. We find that since CPE is generally being sold at net book value plus transaction costs, the primary possibility for the realization of any gains in these sales is the fact that actual transaction costs could be lower than the estimated transaction costs which formed the basis for the sale prices. We conclude that any such difference is likely to be very

[132] SNET Direct Comments at 17–18; SNET Reply Comments at 7; *see* Ameritech Direct Comments at 5–7; Centel Direct Comments at 7; GTE Direct Comments at 33–34; GTE Reply Comments at 8–9; RTC Direct Comments at 3–4.

[133] *See* Idaho Direct Comments at 2; Tennesee Direct Comments at 8–9; *see also* UTS Direct Comments at 11–12; USITA Direct Comments at 12–13.

small and that, therefore, there is no reason for us to adjust our existing accounting rules (with attendant new administrative costs) to account for these small amounts.

XI. OTHER RELATED ISSUES

A. *Intrasystem Wiring*

1. *General Issues*

163. The *Notice* requested parties to comment regarding whether embedded intrasystem wiring[134] should be removed from regulated service in connection with the removal from regulated service of associated CPE. *Notice* at para. 70. With respect to AT&T, the *Notice* directed particular attention to the question of whether transfer of intrasystem wiring to ATTIS could have anticompetitive consequences. *Id.* The comments reflect a general consensus among state commissions that the intrasystem wiring should be detariffed and removed from regulated service.[135] Other parties also support this approach.[136] A number of other commenters express opposition to the transfer of intrasystem wiring to ATTIS.[137] GTE indicates that it does not oppose the transfer of intrasystem wiring from regulated service, but argues that such removal should not be carried out if it would interfere with the attainment of full recovery under regulation of amounts invested in the wiring. GTE Direct Comments at 31; GTE Reply Comments at 15.

164. We conclude that intrasystem wiring currently owned by

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[134] The term "intrasystem wiring" refers to any cable or wiring which (1) is located on a nonresidential customer's side of a demarcation point; and (2) connects station components to each other or to common equipment. The term also includes components associated with intrasystem wiring, such as connecting blocks, terminal boxes, and conduit between buildings or other structures located on the premises of the same customer. This type of wiring also is described as "multiwiring" or "complex wiring."

[135] California Direct Comments at 27; California Reply Comments at 5; District of Columbia Reply Comments at 1; Idaho Direct Comments at 5; Kansas Direct Comments at 3–4; Kentucky Direct Comments at 2; Michigan Direct Comments at 5; New Jersey Direct Comments at 4; New York Direct Comments at 2; New York Comments on AT&T Response to Bureau Letter at 2; North Dakota Direct Comments at 8; Tennessee Direct Comments at 9; Washington Direct Comments at 2.

[136] FEA Direct Comments at 24; USITA Direct Comments at 4 n.4; UTS Direct Comments at 17; UTC Direct Comments at 3. New York suggests that simple inside wiring on the premises of residential customers should be detariffed in this proceeding. New York Direct Comments at 4. This recommendation goes beyond the scope of the issues raised in the Notice and was not addressed by parties filing comments. Accordingly, we will not address the merits of this proposal.

[137] AT&T Direct Comments at 50; AT&T Reply Comments at 51; CBT Direct Comments at 5; IDCMA Reply Comments at 16; ICA Reply Comments at 11; NATA Direct Comments at 27; NATA Reply Comments at 38; SNET Direct Comments at 15; WU Direct Comments at 8.

AT&T or the Independent telephone companies should not be detariffed and removed from regulated service at this time, for two primary reasons.[138] First, the transfer of the wire to ATTIS could have an adverse effect upon competition. The District Court, in approving AT&T's Plan of Reorganization in the divestiture proceeding, has required that intrasystem wiring must be retained by the BOCs. The court was concerned primarily that transfer of the wire to ATTIS could have anticompetitive consequences. Memorandum of the Court at 4, *United States v. AT&T* (D.D.C., filed Aug. 5, 1983). Although we indicated in the *Notice* that such a requirement by the District Court would conflict with our proposal to treat multi-line CPE and intrasystem wiring as an interrelated unit, *Notice* at para. 70 n.46, we now agree with the District Court's ultimate conclusion. Further, we agree with the District Court that transfer of the wire to ATTIS could have an adverse effect upon competition. Through potential tying arrangements and unequal access, the control ATTIS would exercise over access to the wire could drive customers toward favoring ATTIS's CPE products. Competition in the CPE marketplace is better served if the intrasystem wiring is retained by the BOCs and made available on a nondiscriminatory basis.[139]

165. Second, a more equitable result can be achieved by requiring that the unamortized labor costs which form the predominant portion of embedded intrasystem wiring investment be recovered under regulation. To do otherwise would place an undue burden on users of this wiring because these users would become the sole source of revenue for the recovery of investment in this wiring. It would be unfair to require current users to contribute to the recovery of this investment because users in prior years have received the benefit of the capitalization of these labor costs.[140] Further, such removal from

[138] We do not intend to take any position in this proceeding regarding the question of whether intrasystem wiring remaining with the BOCs should be detariffed. This issue is beyond the scope of this proceeding. Our action in deciding the issues before us (*i.e.*, whether multi-line CPE and intrasystem wiring should be treated as an interrelated unit, and whether intrasystem wiring owned by the Bell System should be detariffed and transferred to ATTIS) should not be construed as in any way predetermining our consideration of issues relating to the detariffing of intrasystem wiring which will continue to be owned by the BOCs. *See* para. 165 n.141 & para. 166 n.142, *infra*.

[139] This does not presuppose *how* the BOCs might make the wiring available, *e.g.*, through tariffs or other devices for ensuring nondiscriminatory access to, and use of, the wiring.

[140] New Jersey argues that intrasystem wiring should be shifted from regulated service because retaining the wiring in regulated service could require general increases in local exchange rates as a means of recovering investment in the wiring. New Jersey Direct Comments at 4. State commissions will have a range of options available for the recovery of this investment under regulated service, and we find no reason to speculate here regarding whether any significant increases in basic exchange service rates will occur as a result of the exercise of these options. In this regard, we reject the notion of Idaho and Washington that

regulated service would run the risk that invested amounts never would be recovered, to the detriment of carriers' investors and in possible conflict with the principles of *Democratic Central Committee*. We already have taken action to establish a schedule for the amortization of these unrecovered costs under regulation.[141]

166. Some commenters argue that ATTIS would gain a pricing advantage over its competitors if the intrasystem wiring remains with the BOCs because ATTIS would not have to reflect any wiring charge in its rates for CPE. California Direct Comments at 28; District of Columbia Reply Comments at 1. This argument, however, ignores the fact that CPE users would be paying a charge to the BOCs for the intrasystem wire in addition to charges for the acquisition of CPE, and that users would face this circumstance regardless of whether they obtain their CPE from ATTIS or another vendor. We do not discern any pricing advantage to ATTIS in these circumstances. The argument also is made that intrasystem wiring should be transferred merely because it is closely associated with multi-line CPE. Michigan Direct Comments at 5; New Jersey Direct Comments at 5; New York Direct Comments at 2; UTC Direct Comments at 3. We have concluded, however, that the association between embedded CPE and embedded intrasystem wiring is not a sufficient basis for going forward with the detariffing of the wiring at this time, particularly in light of the considerations we already have described regarding the advantages of retaining the wire under tariff. Further, we have concluded that the fact that users will have to deal with two different vendors (the BOCs for the wire and ATTIS for embedded CPE) should not pose a significant problem for users and is not sufficient grounds for detariffing the associated wiring. Multi-line users have ample experience in dealing with a variety of telecommunications vendors. Currently, for example, they may obtain transmission services and CPE from different sources. Whatever inconveniences may be caused by these sorts of arrangements is

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there will be no revenue stream for the intrasystem wiring if it is retained under regulation. Idaho Direct Comments at 5; Washington Direct Comments at 2. It is important to stress, however, that the decision by regulatory commissions to capitalize labor costs associated with intrasystem wiring, rather than requiring that these costs be expensed at the time they were incurred, contemplated that these capitalized costs eventually would be recovered through the regulated rate structure.

[141] Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with Respect to Accounting for Station Connections, Optional Payment Plan Revenues and Related Capital Costs, Customer Provided Equipment and Sale of Terminal Equipment, First Report and Order, 85 FCC 2d 818, 829–30 (1981) (hereinafter Station Connections Order). We note that a question arises as to whether the carriers or their customers should own and maintain this wiring once it is completely amortized and carriers have recovered their costs for this investment. This question goes beyond the scope of this proceeding, however, and it will be addressed by the Commission in a separate action.

a marginal concern when weighed against the anticompetitive risks inherent in transferring the wire to ATTIS.[142]

2. *CPE Station Handling Costs*

167. A portion of account 232, "Inside wiring," represents investment associated with the installation and testing of CPE. This investment primarily represents capitalized labor costs relating to this installation and testing, and these costs are not disaggregated in the account but instead are combined with other capitalized costs included in the account. Several state commissions argue that these station handling costs should be added to net book value in connection with the transfer of the embedded CPE base out of regulated service. The only extensive discussion in favor of this approach is made by IDCMA. AT&T argues that no adjustment to net book value of the embedded CPE base should be made to take into account station handling costs.

168. We conclude that station handling costs should not be added to net book value upon removal of the embedded CPE base from regulated service. First, the costs relating to station handling are unamortized labor costs which have been capitalized pursuant to policies of state commissions. Ratepayers have received a benefit from these policies because rates for providing CPE have been reduced by not charging customers for installation and testing costs at the time these costs were incurred. These regulatory policies have contemplated that this ratepayer benefit would be balanced by the eventual recovery of these costs from the general body of ratepayers through the amortization of these costs in account 232. Such an approach is required in order to permit carriers' investors to recover these capitalized labor costs. The transfer of these costs to unregulated service (by adding the costs to the net book value of the embedded CPE base) would deprive investors of the fair opportunity to recover their investment from revenues generated by carriers' regulated activities. Second, such an approach would not be consistent with our decision in *Station Connections Order*, 85 FCC 2d 888 (1981), that these station handling costs should be recovered under regulation over a 10-year amortization period. Third, there is no workable basis

[142] Our disposition of the intrasystem wiring issue moots the proposal made by some commenters that AT&T should be required to offer the wiring for sale to in-place customers in connection with removal from regulated service and transfer to ATTIS. Darden Direct Comments at 3; IDCMA Direct Comments at 18. Several commenters suggest that the maintenance of intrasystem wiring should be detariffed. AT&T Direct Comments at 63–65; SW Bell Direct Comments at 4; UTS Direct Comments at 17. Such action was not proposed in the Notice and we have concluded that this proceeding is not the proper forum for pursuing this suggestion. We reject the notion advanced by ATU that each carrier should be given discretion to decide whether its intrasystem wiring should be detariffed. ATU Direct Comments at 12.

upon which to determine the amount of these unamortized station handling costs. As we noted,[143] capitalized labor costs associated with station handling are not treated separately in account 232, and no commenter has suggested any methodology under which an accurate disaggregation could be achieved.[144] Any attempt at such a disaggregation could be costly and time-consuming, and there is no assurance that any such attempt would produce reliable results.[145]

169. A few commenters argue that ATTIS will receive a competitive advantage if unamortized station handling costs are not added to net book value. IDCMA Direct Comments at 15; New Jersey Direct Comments at 5. The assertion is made that ATTIS will be getting the CPE at an "off-the-shelf" value even though the equipment is already installed. If any advantage is being created by the decision not to increase net book value by the amount of station handling costs, this advantage can be captured by in-place customers (and thus denied to ATTIS) by their purchasing the embedded CPE at net book value, as they are permitted to do pursuant to our decision in this proceeding. Other commenters maintain that these station handling costs are associated with the embedded CPE and that this requires that the costs be transferred together with the CPE. Michigan Reply Comments at 4; New York Direct Comments at 4. This argument, in our view, overlooks the fact that, as we have described, the very existence of these unamortized costs is the result of past regulatory decisions to benefit ratepayers by capitalizing rather than expensing the costs. It is clear that ratepayers would receive a double benefit if these unamortized costs were added to net book value, since they have benefitted from the expensing of these costs in prior years and they would benefit from the addition of these costs to net book value of the transferred CPE because this would have the effect of reducing carriers' revenue requirements.

B. *CPE Associated with NSEP Communications Systems*

170. FEA argues that a "significant operational problem" is posed for a limited number of national security and emergency preparedness (NSEP) systems and circuits used by the Federal Government as a result of the transfer of the embedded CPE base from the BOCs to AT&T under the MFJ and the prospect of the

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[143] Para. 167, *supra*.

[144] IDCMA notes that the New York Public Service Commission has estimated that station handling costs represent 35 percent of the total costs capitalized in account 232. IDCMA Direct Comments at 15.

[145] Carrier recordkeeping may not be sufficiently detailed to enable an audit to determine with any precision the time actually spent by BOC employees in installing and testing CPE. The District Court in United States v. AT&T has reached a similar conclusion regarding the difficulty of determining these costs. Memorandum of the Court at 5 & n.9, United States v. AT&T (D.D.C., filed Aug. 5, 1983).

detariffing of the embedded base pursuant to action by the Commission in this proceeding. FEA Direct Comments at 6. FEA notes that under current arrangements AT&T Long Lines "functions as a single point of contact, either providing or being responsible for a comprehensive transmission network and CPE solution, when the Federal Government has determined that a comprehensive, integrated response is necessary." *Id.* The Federal Government relies upon Long Lines to deal with other entities in the Bell System, Independent telephone companies, and CPE vendors for a variety of its communications needs, including the maintenance and repair of embedded CPE. FEA indicates that Long Lines is in daily contact with the Federal Government as a means of ensuring that existing national private line and common user networks or circuits are effectively maintained on an end-to-end basis. *Id.* at 7.

171. FEA contends that a single entity with end-to-end responsibility is critical for overall system performance, and argues that the Federal Government could not effectively coordinate multiple suppliers for portions of these communications systems. *Id.* FEA asserts that the transfer of embedded CPE used in connection with these systems to ATTIS would fragment the provision of the Federal Government's critical service needs. *Id.* at 10. FEA notes that three categories of command and control and emergency warning systems and circuits are involved: embedded CPE associated with services vital to NSEP functions and concerns; embedded CPE provided under classified contracts; and embedded CPE filed in Commission tariffs and used to provide temporary services in connection with domestic and foreign travel by the President. *Id.* at 13.[146] Only

[146] FEA lists the following systems and circuits as being covered by its request that CPE associated with NSEP functions not be detariffed and transferred to ATTIS: (1) The following Department of Defense systems: Automatic Secure Voice Communications Network (AUTOSEVOCOM); Joint Chiefs of Staff systems (JCS Alerting Network and Minuteman); Strategic Air Command systems (SAC Primary Alerting System; SAC Operations Conference System; and SAC Command Post Command and Control Consoles); North American Air Defense Command (NORAD) Alerting System; Tactical Air Command systems (TAC Command and Control Alerting System and TAC Force Control Management System); Military Airlift Command (MAC) Operational Phone System; Air Force Digital Graphics System (AFDIGS); Air Force Command Post Alerting Network (COPAN); and Air Force Command Post Record Capability (COPREC). (2) The U.S. National Airspace System in the Federal Aviation Administration. (3) The following Federal Emergency Management Agency systems: a classified FEMA system provided under AT&T Tariff FCC No. 260; Emergency Broadcast System; FEMA National Voice System; and FEMA National Warning System. (4) The NRC Emergency Notification System in the Nuclear Regulatory Commission. (5) The following White House Communications Agency systems and equipment: transportable electric consoles; Echo Fox Radio System. FEA Direct Comments at 12–13. The Central Command systems in the Department of Defense (CENTCOM Army Alert Hotline, CENTCOM Air Force Alert Hotline, and CENTCOM Navy/Marine Corps Alert Hotline) were originally listed by FEA but later were deleted because Long Lines currently is not responsible for CPE for these systems. *See* FEA Reply Comments at 3.

AT&T has commented on FEA's proposal, noting that it "endorses the suggestion that certain specialized systems remain with AT&T's interexchange organization." AT&T Reply Comments at 15 n.*. AT&T suggests that the Commission consider the issues raised by FEA in a separate proceeding so that FEA's special concerns can receive "more focused attention . . . ." *Id.*

172. We agree that FEA has drawn attention to serious issues relating to the provision of communications systems for the national defense. Those who are responsible for regulating the Nation's telecommunications industry have a special responsibility to ensure that the industry is not hindered in its efforts to assist the Federal Government in meeting its defense-related communications needs. *See, e.g.*, Section 1 of the Communications Act of 1934, 47 U.S.C. § 151. We have consistently recognized this special responsibility and have sought to act in a manner which advances these defense-related goals.[147] In this instance, however, we are convinced that the deregulatory policies of *Second Computer Inquiry* can be permitted to go forward without causing any adverse effect upon the Nation's national security and emergency preparedness. We conclude, therefore, that the CPE identified by FEA shall be detariffed and transferred to ATTIS subject to the same requirements and procedures established in this *Order* for other CPE in AT&T's embedded base. We recognize, however, that, as has been argued by AT&T, the issues raised by FEA might benefit from a more detailed examination by interested parties than has been given thus far in this proceeding. We are amenable to the suggestion that a subsequent separate proceeding would provide an appropriate forum for a more expansive consideration of FEA's concerns. We shall provide, therefore, that this portion of the *Order* shall not take effect until June 1, 1984, thus affording interested parties sufficient opportunity to petition the Commission for a waiver of the application of the requirements established herein to the special systems and circuits identified by FEA in its pleadings.[148]

173. We conclude that an exception to our *Second Computer Inquiry* deregulatory principles is not warranted in the case of CPE

[147] *See, e.g.*, MTS and WATS Market Structure, CC Dkt. No. 78–72, Phase III, Notice of Proposed Rulemaking, FCC 83–178, 48 Fed. Reg. 26632, at para. 58 (released May 31, 1983); American Telephone and Telegraph Co., Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations with Respect to the Department of Defense and Specified Government Agencies, Memorandum Opinion and Order, FCC 83–143 (released Apr. 12, 1983) (hereinafter DOD Waiver Order).

[148] *See* para. 171 n.146, *supra*. FEA has indicated that minor additions to, or deletions from, the list may be necessary. FEA Direct Comments at 12 n.*. It is our understanding that the bulk of this NSEP-related CPE is owned by Long Lines, but portions of these assets are currently owned by the BOCs and will be transferred to AT&T at divestiture. Until the June 1, 1984, effective date, we would expect that this transferred CPE would be placed in regulated service by AT&T and tariffed at the federal level.

associated with NSEP communications systems because we are not convinced that FEA is correct in its broad assertion that a "single entity with end-to-end responsibility" is necessary to ensure the effective operation of NSEP communications systems.[149] We already have required that, after divestiture, "any provision of new CPE to DOD . . . must be in compliance with the requirements of Computer II. . . ." *DOD Waiver Order* at para. 18. Further, it is well established that "[n]o one entity need provide all interconnection equipment for our telephone system any more than a single source is needed to supply the parts for a space probe." *Carterfone*, 13 FCC 2d 420, 424, *reconsideration denied*, 14 FCC 2d 571 (1968). The record before us does not support a conclusion that requiring the Department of Defense and other federal agencies to rely on ATTIS for maintenance and service relating to embedded CPE transferred to ATTIS will cause harm to NSEP communications systems. In the absence of a compelling showing, we find no reason to refrain from deregulating embedded CPE associated with NSEP communications systems in a manner consistent with the principles and requirements of *Second Computer Inquiry*. Further, we find that the benefits which competition could bring to this area are sufficient reason to go forward with deregulation.

C. *Independent Telephone Companies and Record Carriers*

174. We recognized in the *Notice* that the MFJ has required us to address expeditiously implementation of *Second Computer Inquiry* principles regarding the embedded base of the Bell System, but that this factor has no application with regard to the Independents or the record carriers. *Notice* at para. 71. We have focused our efforts on rendering a decision with regard to the Bell System in order to have our decision in effect before the divestiture takes place. In so doing, we have found it unnecessary to attempt also to reach a final decision regarding the detariffing of the embedded base of the Independents and the record carriers.

175. In addition to the fact that there is no compelling reason for action by the end of this year, we also have concluded that there are advantages in postponing action. We proposed in the *Notice* that principles and guidelines which we establish for AT&T also would be made applicable to the Independents and record carriers. In the wake of our action today, the Independents and record carriers will have an opportunity to assess these principles and guidelines in their

[149] FEA cites only one study in support of the proposition that the lack of end-to-end responsibility "could result in system or circuit malfunction." FEA Direct Comments at 7. That study, conducted by NCS and the Department of Defense in 1981, measured the frequency of circuit outages occurring in connection with Bell System-provided end-to-end services as compared to outages occurring in "circuits provided by a combination of Bell System and other carriers." *Id.* at 7 n.*. It is not clear from FEA's description of this study whether its findings focused on determining whether CPE *per se* was a cause of circuit outages.

final form. Further, comprehensive detariffing plans for the Independents were proposed in the final round of comments[150] and it may be useful to study further these latest proposals. Consequently, we will focus additional attention on issues relating to the Independents and record carriers, and we will endeavor to take subsequent action in this docket on these matters early in 1984. This subsequent action also will encompass the issues of accounting requirements for Independents and record carriers in connection with their embedded CPE activities, accounting for proceeds from the sale of CPE under regulation by the Independents, the valuation of CPE supporting assets (including land and buildings) transferred to unregulated activities by the Independents and record carriers, and the treatment of embedded CPE owned by the Independents and tariffed with this Commission rather than the state commissions.

XII. EMBEDDED CPE CAPITALIZATION PLAN

A. *Summary of AT&T's Embedded CPE Capitalization Plan*

176. Section 64.702(d)(4) of the Commission's Rules provides that carriers subject to the separate subsidiary requirement must obtain Commission approval as to the manner in which the separate corporation is to be capitalized and must obtain Commission approval of any modification to a Commission approved capitalization plan. In compliance with this provision, AT&T filed on January 21, 1983, the fourth supplement to its plan for the capitalization of ATTIS (Supplement) (File No. ENF 83–18). Earlier plans and supplements had been filed and approved in connection with ATTIS's offer of enhanced services, new CPE, and Picturephone Meeting Service, respectively.[151] The Commission's review of each of these earlier plans addressed: (1) AT&T's proposed level of funding of the separate subsidiary, the impact of this funding on quality and rates of basic services, and whether that impact, if any, required modifications or conditions to the proposed funding; (2) the amounts of "preapproval" or "preoperational expenses," (that is, expenses which were recorded on the books of regulated operations but which benefitted ATTIS) and whether regulated operations should be reimbursed for these expenses; and (3) whether AT&T's plans for the

[150] *E.g.*, GTE Reply Comments at 7–14.

[151] *See* Request for Approval To Capitalize a Separate Subsidiary To Provide Enhanced Services Pursuant to Section 64.702(d)(4) of the Commission's Rules, 90 FCC 2d 404 (1982) (Enhanced Services Capitalization Plan Order); Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide New Customer Premises Equipment, Phase I, 91 FCC 2d 578 (1982) (New CPE I); Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide Picturephone Meeting Service, Mimeo No. 1600 (released Dec. 30, 1982); Request for Approval To Supplement the Capitalization of American Bell Inc. To Provide New CPE, Phase II, FCC 83–123 (released Apr. 13, 1983) (New CPE II).

operation of ATTIS were consistent with the structural separation requirements of *Second Computer Inquiry.*

177. The funding level currently approved totals approximately $4.7 billion through 1986. This Supplement seeks Commission approval of approximately $6.6 billion of additional capitalization in connection with the transfer to ATTIS of embedded CPE and related assets (collectively, embedded base) from AT&T and the BOCs. On March 29, 1983, AT&T filed in CC Docket 81–893 a proposed plan for the detariffing of the embedded base and its transfer to ATTIS by January 1, 1984. The plan was amended by AT&T's August 1, 1983, filing and other filings.[152] The January 21 capitalization Supplement is intended to specify the means by which to effect the March 29 plan, as amended. This *Order* will follow the pattern established by our earlier capitalization reviews. The remainder of this section will summarize AT&T's January 21 Supplement. Section B will address issues raised by the proposed increase in the level of capitalization; Section C will discuss the impact of this capitalization on the quality and rates of basic services; and Section D will dispose of matters associated with preapproval expenses. Issues concerning the operation of ATTIS are addressed throughout Parts VI and VII of this *Order.*

178. AT&T estimates that the net book value of the embedded base will be approximately $9.4 billion. The adjusted net book value will be $6.6 billion.[153] ATTIS will issue shares of its common stock to the transferring entities in exchange for the transferred assets. According to AT&T's Supplement, the equity capital represented by these shares, as recorded in ATTIS's books, will be equal to the adjusted net book value of the transferred assets and will reflect $1.6 billion of BOC indebtedness which will be assumed by ATTIS.[154] The ATTIS shares issued to the BOCs will be distributed to AT&T so that it will continue to be the sole shareholder of ATTIS.

179. The $1.6 billion of BOC indebtedness which will be assumed by ATTIS is owed to AT&T. This debt will move with the transferred assets in order to assure that the BOCs will be divested with debt ratios no greater than those permitted by the MFJ. AT&T will cancel

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[152] *See generally* Parts I and II, *supra.*

[153] AT&T defines "adjusted net book value" as original cost less the depreciation reserve, less deferred taxes, less unamortized ITCs, plus the deferred income tax on restored Western Electric profits. *See* Notice at para. 6 n.7.

[154] This does not reflect AT&T's announced year-end write-down of assets and other bookkeeping adjustments to AT&T's non-regulated corporate books. *See* Wall Street Journal, Oct. 20, 1983, at 5. No record statements in this proceeding discuss those adjustments. We must assume they have no effect on AT&T's plan for the capitalization of ATTIS. If AT&T's year-end adjustments prove to be inconsistent with the record in this proceeding, AT&T should file with this Commission, no later than 30 days following the release of this Order, a description of any such inconsistency.

the $1.6 billion BOC indebtedness which will have been assumed by ATTIS, and, in exchange, AT&T will accept common stock of ATTIS.

180. On February 28, 1983, eleven parties filed comments (hereinafter Capitalization Comments) on AT&T's fourth supplement.[155] Three of these parties and AT&T filed reply comments on March 15, 1983 (Capitalization Replies).

B. *Capitalization*

1. *Apportionment of BOC Debt*

181. As summarized above, AT&T proposes to transfer to ATTIS some of the debt currently held by BOCs which will comprise five of the seven regional Bell operating companies (RBOCs). The stated purpose is to achieve compliance with the divestiture's requirement that the RBOCs not bear greater than specified debt ratios. New York argues that ATTIS should assume a share of the BOCs' debt proportionate to the assets it will receive. New York Capitalization Comments at 6. Supporting such a requirement is the fact that acquisition of CPE contributed significantly to BOC capital requirements which were met in substantial part by debt. Unregulated operations would obtain the current benefit of past BOC capital asset acquisitions while regulated operations may retain a disproportionate share of the remaining liabilities which had been incurred in support of those acquisitions. New York also argues that the debt to be assumed by ATTIS should not bear the average cost of BOC debt but should bear a higher rate of interest to reflect the fact that most of the assets to be transferred are of recent vintage and therefore may be associated with more recent debt issues bearing a higher-than-average interest rate. *Id.*

182. For the following reasons, we will not require AT&T to alter its treatment of debt which it intends ATTIS to assume. We recognize that New York proposes rigorous allocation of BOC debt to ATTIS in order to achieve fairness to ratepayers. Such allocation, however, is likely to be exceedingly complex and ultimately may prove to be self-defeating. New York's proposed allocation by vintage would require a difficult, expensive, and time-consuming disaggregation of the transferred assets by year of acquisition in order to determine which portion of BOC debt should be attributed to ATTIS. Even if such an effort were undertaken, it is not clear that the

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[155] Commenting parties are: the People of California and the Public Utilities Commission of the State of California (California), the Computer and Business Equipment Manufacturers Association (CBEMA), GTE Service Corporation (GTE), International Communications Association (ICA), the Independent Data Communications Manufacturers Association Inc. (IDCMA), New York State Department of Public Service (New York), North American Telephone Association (NATA), Southern Pacific Communications Company (SPCC), Tandy Corporation (Tandy), United Technologies Communications Company (UTCC), and United Telephone Systems, Inc. (UTS).

allocation will effect a more favorable result for ratepayers. The assets to be transferred may include a substantial number of older items which may be associated with lower-than-average costs of debt.

183. A further reason for approving AT&T's proposed treatment of debt is that alternative methods may conflict with the MFJ's conditions. On the present state of the record we cannot say whether adoption of New York's proposal will result in reduced or increased amounts of BOC debt to be assumed by ATTIS. If the amount of BOC debt attributed to ATTIS is reduced, the maximum BOC debt levels prescribed in the divestiture may not be achieved immediately and our implementation of *Second Computer Inquiry* may appear at odds with the divestiture. The MFJ's provisions on this point do not appear unreasonable, and, therefore, there is no cause to invite such complexity.

184. Also, to the extent that we are concerned with ATTIS's financial structure, we have power, pursuant to Section 64.702(d)(4) of the Commission's Rules, to require modification of AT&T's proposed assumption of debt by ATTIS. However, little would be accomplished by such modification. If, as a result of Commission requirements, ATTIS were to hold more debt than AT&T found desirable, AT&T could reduce the subsidiary's debt level pursuant to its Commission-approved power to provide ATTIS up to $4.7 billion of funds. A final reason for declining to modify AT&T's proposal is that if the Commission were to require transfer of BOC debt, such action may impinge on debt issuers' rights or expectations.

185. GTE expresses concern that the proposed transfer of debt may affect the results of interstate toll settlements formulae which are based on debt/equity ratios. GTE Capitalization Comments at 11–12. GTE believes that some of the BOCs' debt will be assumed by ATTIS prior to divestiture proportionate to the transfer of the facilities which ATTIS will obtain from the BOCs in order to test embedded CPE support systems. When the debt/equity ratios of the BOCs are reduced, the return of all exchange carriers (Independents and BOCs) will be reduced. GTE argues that such transfers should not occur until required by divestiture implementation. Very few facilities, however, will be transferred prior to divestiture. Subsequent to the filing of GTE's Capitalization Comments, AT&T indicated that pre-divestiture transfer of facilities will be limited to one jurisdiction. Northwestern Bell Telephone Company, Petition for Waiver, File No. ENF 83–35, at 9 (filed May 26, 1983); AT&T Further Supplementary Comments at 19. Thus, if we assume with GTE that debt assumption is phased with asset transfer, the pre-divestiture transactions do not appear to have sufficient impact on the toll settlements process to warrant extraordinary consideration here of this one among many toll settlements items. If the impact on toll settlements nevertheless proves to be significant, this can be

addressed in a forum which takes into account a broader range of toll settlements matters.[156]

2. *Accrued Payroll and Benefits*

186. ATTIS will assume liability for $106 million of accrued payroll and benefits expenses of BOC employees who are transferring to ATTIS. The BOCs will pay ATTIS $106 million in cash throughout 1984 on a schedule which approximates the timing of actual payments of accrued payroll and benefits to ATTIS employees who will have transferred from the BOCs. California argues that there is no justification for imposing on BOCs the liability for future payments by ATTIS to its own employees. California Capitalization Comments at 16.

187. We find that AT&T's Supplement does not improperly burden the BOCs with accrued payroll and benefits associated with transferred BOC employees. These accrued benefits (*e.g.*, accumulated vacations) were earned by BOC employees prior to transfer but are not due for disbursement to or on behalf of the employees until after transfer. The mechanism proposed by AT&T affords the BOCs use of the funds until the time they would have been paid to the employees had they not been transferred. Because the BOC liabilities at issue were triggered by employee efforts that benefitted the BOCs, AT&T's plan does not appear to be unfair. This same mechanism was proposed by AT&T in the new CPE capitalization plan which the Commission has approved. *See* Supplement to Plan of AT&T for Capitalization of American Bell Inc. at 8 (filed July 1, 1982); *New CPE I.*

3. *"Expensed Assets"*

188. Included in the embedded base proposed for transfer to ATTIS are items which were purchased by the BOCs and expensed for accounting purposes (*e.g.*, office supplies, shelving). New York argues that these items have value beyond the year in which their costs were incurred, and they were paid for by the carriers' subscribers. New York Capitalization Comments at 9; *see also* New York Direct Comments at 8–9. New York asks the Commission to require that AT&T repay the BOCs for these items at their economic

[156] Also irrelevant to this proceeding is GTE's request that the Commission assure the toll settlement process should not include AT&T's costs of defending the antitrust suit and implementing its settlement. The Telecommunications Industry Advisory Group has been given the responsibility of recommending to which account settlements of antitrust suits should be reported. *See* Litigation Expenses of Common Carriers, 92 FCC 2d 140 (1982). The group has not yet issued its recommendations in this area, but we are expecting to issue a notice of proposed rulemaking sometime in 1984 to reflect its recommendations. In the meantime, any costs which are believed to be improperly included in rates can be challenged in a ratemaking proceeding.

value. AT&T argues that these items were expensed in the normal course of the BOCs' business and the BOCs will incur no further costs for these items as a consequence of their transfer. AT&T Capitalization Reply at 30. In addition, there is no way of knowing what value, if any, these prior expense items might have to ATTIS. Finally, AT&T argues, because these items were expensed in the course of BOC competitive CPE operations, there is no basis for refunding any of these amounts to benefit the BOCs' exchange telecommunications business.

189. In our earlier capitalization plan orders, we required reimbursement by AT&T for "pre-approval" expenses which benefit ATTIS but were incurred by regulated operations. *See also* Part XII.D.1., *infra*. AT&T does not deny that the "expensed assets" at issue here will benefit ATTIS's operations. Assuming perfect rate regulation, however, the costs of those assets have been wholly paid for by ratepayers. In our earlier capitalization plan decisions we required AT&T to reimburse regulated operations in the amount of pre-approval expenses that benefit ATTIS. *See* para. 176 n.151, *supra*. We will apply the same principle to assets the costs of which were expensed in a period prior to approval. The extent to which these expenditures benefit ATTIS can be determined as follows. The value of these expensed assets endures beyond the moment the associated expenditure is incurred. Were it otherwise, there would be no such assets to transfer to ATTIS. The precise duration of this value is uncertain. We can assume it is no greater than one year to the extent that expensing an item in a given year indicates that its value is consumed within that year. Thus, for the purpose of this *Order*, we will assume that the value of an expensed asset endures for precisely one full year from the date the associated expenditure is incurred. We will assume further that the expensed assets were acquired at a constant rate throughout 1983. Half their value, consequently, will remain for consumption by ATTIS during 1984. Thus, if these expensed assets are transferred to ATTIS on January 1, 1984, ATTIS should reimburse the regulated entities for 50 percent of the original costs of these assets acquired in 1983.

190. "Exempt materials" (*e.g.*, wires, cable) used in the installation and maintenance of CPE may provide an exception to this requirement. The pleadings do not explicitly refer to exempt materials but only cite, by way of example, office supplies. Despite this silence, exempt materials are a type of "expensed asset." To that extent, they should be treated in the same manner as the expensed assets. Our review of the BOCs' provision of installation and maintenance services to ATTIS's new CPE operations, however, has required that ATTIS bear an allocation of exempt materials expenses. AT&T may subtract from 1983 exempt materials expenses those amounts that previously have been allocated to ATTIS. AT&T

shall then reimburse the BOCs 50 percent of the unallocated balance of 1983 exempt materials expenses.

191. No later than 30 days after the release date of this *Order*, AT&T shall report to the Chief of the Common Carrier Bureau on the following: the identity of items which fit the above description of "expensed assets," including exempt materials; the numbers or amounts of these items; the amount of expense associated with these items; and the timing of reimbursement. The method of reimbursement should be that prescribed in *New CPE I*, 91 FCC 2d at 598–604.

4. *Reconciliation with Regulated Accounts*

192. ICA contends that AT&T has underestimated the net book value of the CPE to be transferred to ATTIS. ICA Capitalization Comments at 16–20. In support, ICA provides the results of its study using data filed by the New York Telephone Company in a recent general rate hearing. ICA's study purports to show that as of December 31, 1983, the net investment in the New York CPE rate base will be $1.059 billion. In contrast, AT&T's Supplement estimates that the net plant value of CPE to be transferred to ATTIS from the New York rate base is $792.4 million. The capitalization plan figures are thus $266.5 million lower than the figures ICA derived from the New York hearing data. Extrapolating that difference nationwide, ICA discerns a $3 billion discrepancy. ICA provides similar results of studies pertaining to the seven jurisdictions of Mountain Bell and the five jurisdictions of Southwestern Bell. AT&T responds that 90 percent of the discrepancy argued by ICA can be explained by ICA's alleged failure to subtract book depreciation reserves. AT&T Capitalization Reply at 33. If so, observes AT&T, ICA used gross, not net, investment data. Tandy complains that AT&T provides little or no cost support for its conclusion that the adjusted net book value of the assets is $6.6 billion. Tandy Capitalization Comments at 22. AT&T responds that it will be neither feasible nor useful to provide further detail. The effect of retirements cannot be predicted and a final inventory will take months to complete.

193. Parties' objections concerning the accuracy of capitalization amounts do not require modification of AT&T's Supplement. The information in the embedded CPE capitalization Supplement concerning the assets to be transferred contains essentially the same level of detail as the earlier capitalization filings which the Commission approved. The dollar amounts, however, are very large in this capitalization Supplement. Even if AT&T correctly claims that ICA committed as elementary an oversight as confusing gross and net investment, AT&T provides a rather vague explanation of

the remaining 10 percent of the alleged discrepancy between capitalization plan asset values and regulated account values.[157] When net book value approaches $10 billion, even a 10 percent discrepancy can be consequential. Accordingly, we require that the staff include in its ongoing audit of *Second Computer Inquiry* implementation, a plan for obtaining a reconciliation of regulated accounts with capital asset transfers.

C. *Effect on Basic Service Quality and Rates*

194. During 1982, the Commission approved a five-year, $4.7 billion capitalization of ATTIS's operations. *See New CPE I*, 91 FCC 2d at 584–85. The Commission's decision reflected its concern that if AT&T sought to provide ATTIS the approved amounts, it may divert resources from basic service. It may also raise AT&T's total capital requirements to the point that its cost of capital also would rise. This increased overall cost of capital may become confused with the basic services cost of capital. We found, however, that because regulated CPE investment was capped by *Second Computer Inquiry* the estimated cash flow of embedded operations would be available to support new CPE operations and relieve AT&T of the need to go to outside funding sources. *Id.* In short, the $4.7 billion capitalization constituted no additional capital requirements for AT&T's business. On the other hand, when the embedded base is transferred to ATTIS pursuant to this *Order* and if earlier-approved funding levels are not reduced, it would appear that AT&T will continue to be authorized to provide ATTIS with $4.7 billion in addition to the embedded base cash flows which will have become a part of ATTIS's internal operations. Thus, if AT&T seeks to act on our earlier authorizations after ATTIS has obtained the embedded base, AT&T may create additional capital requirements for its business. AT&T then may be required to go to outside sources and thereby revive the concerns disposed of in *New CPE I*. This raises the question of whether ATTIS's authorized funding level should not be reduced to reflect the intent of the earlier authorizations.

195. Another asset transfer raises the same issue. Earlier this year, following our most recent approval of ATTIS capitalization and prior to the adoption date of this *Order*, AT&T transferred the Consumer Products Division from ATTIS to Western Electric. This involved transfer of approximately $12 million in assets at adjusted net book value and will account for a reduction of $250 million in funding needs over the planning period. AT&T Response to Bureau Letter at 38–40. We must determine whether ATTIS's authorized funding level should be reduced to reflect this reduction of the scope

[157] AT&T lists without explanation examples of other items which would "further reduce any remaining disparity." They are: retention factors, estimated 1983 depreciation rates, and specific jurisdictional transfer schedules. AT&T Capitalization Reply at 33.

of ATTIS's operations. In response to these concerns, AT&T states that ATTIS must still be funded up to the $4.7 billion approved by the Commission. AT&T states, however, that the authorized funding amount may be lessened by the $250 million associated with the Consumer Products Division. *See id.* We find that it is appropriate to reduce AT&T's funding authorization by $250 million.

196. AT&T further states that upon transfer of the embedded CPE on January 1, 1984, ATTIS's funding requirements will be provided out of funds derived from new and embedded CPE revenues which will be flowed from ATTIS to AT&T. This will not give rise to a need for external financing or a diversion of revenues from basic services. *Id.* To the extent that the funds flowed from ATTIS to AT&T approximate amounts which could be projected as embedded CPE cash flow, we agree with AT&T that the embedded base capitalization will not cause directly an increase in AT&T's overall financing needs. Accordingly, this capitalization will not further burden this Commission's or other commissions' ability to assure that neither the quality nor rates of basic service will be affected detrimentally. We do not disturb AT&T's aggregate funding to ATTIS of $4.7 billion, less $250 million associated with the Consumer Products Division, and we approve AT&T's proposed capitalization in connection with the transfer to ATTIS of the embedded base assets valued at approximately $6.6 billion, adjusted net book value.

D. *Pre-Approval Expenses Associated with Proposed Asset Transfer*

1. *Direct Expenses Related to Transfer and Conversion of CPE*

197. AT&T's embedded CPE capitalization supplement reports on the BOC-incurred costs of facilities which, prior to their transfer to ATTIS, will be used by the BOCs to convert embedded CPE to ATTIS's unregulated offerings. NATA complains that AT&T omits "reformulation" costs, that is, the expenses associated with the purchase, outfitting, and use of facilities as well as the cost of their ultimate transfer to ATTIS. NATA Capitalization Comments at 15. In addition, GTE argues that the capitalization plan fails to reflect a disparate set of items which it calls "disposition" costs. GTE Capitalization Comments at 9–11. Among these are rehabilitation of CPE to be transferred and "CPE transfer costs" including, *e.g.*, administrative costs, physical asset transfer, storage space, computer costs, and employee time. (See Part XII.D.2., *infra*, for a discussion of the remainder of GTE's disposition costs.)

198. AT&T states that it is appropriate for the BOCs, in protection of their own interests, to incur expenses relating to the development of accurate and complete customer records, identifying and inventorying the assets that the BOCs will transfer and determining their adjusted net book value. AT&T Capitalization

Reply at 34–35. AT&T states that all other reformulation costs will be borne by ATTIS. *Id.* at 34. AT&T's plans concerning of the BOCs' transfer and conversion costs affords identical treatment of what may be two distinct sets of costs: (1) transfer and conversion of CPE; and (2) transfer and conversion of CPE customer records. As to the first, these activities undoubtedly benefit ATTIS. Because those costs, however, will be incurred in compliance with the Commission's regulatory requirement (adopted today) that these assets must be removed from the books of the BOCs' regulated operations, it is not unfair to regard the costs of the transfer of CPE as regulated costs. Thus, AT&T correctly states that accurate and complete identification and valuation of CPE assets to be transferred will protect BOC interests and, therefore, the costs of these activities are properly borne by the BOCs. To the extent that specific facilities are devoted to these activities, the BOCs properly bear the associated facilities "reformulation" costs of which NATA complains. Also included among these transfer and conversion costs properly borne by the BOCs are those expenses identified by GTE as "CPE transfer costs."

199. As to the second set of costs, transfer and conversion of CPE customer records, we are less certain of the extent to which these costs benefit regulated operations or follow from our regulatory requirement that CPE must be removed from regulated books. Certainly the BOCs have an interest in accurately billing their exchange service customers; therefore, they must segregate the costs of embedded equipment from BOC service charges. The BOCs, however, do not benefit from any efforts devoted to reformatting customer records for use by ATTIS. We direct the staff to assure, in the course of its ongoing *Second Computer Inquiry* implementation audit, that BOC-borne costs of "transfer and conversion" of CPE customer records include none of the costs of reformatting records for use by ATTIS.[158]

200. Concerning the refurbishing expense of CPE to be transferred, it appears that AT&T plans to charge all such expense to ratepayers as a part of exchange service expense. *See* AT&T Response to Bureau Letter at 10 and Appendix D. AT&T argues that refurbishing expense is an ongoing expense which is reflected in extended service life of CPE and which thus lowers depreciation rates and raises net book values of embedded CPE. *Id.* at 10. We agree that because refurbishing expense is a factor in establishing depreciation rates, ratepayers have benefitted in the past from such expense by virtue of the consequent reduction of depreciation expense that otherwise would have been recovered in rates. Also, upon detariffing of CPE, the ratepayer will be protected to the extent

[158] We expect to find that all of these reformatting costs either will be borne directly by ATTIS as a cost of its own activities or will be included among charges by the BOCs to ATTIS for support services. *See* Part VIII.A.2., *supra*; *see also* Part XII.D.3., *infra*.

that CPE is removed from regulated accounts at net book values which reflect the effects by refurbishing expenses.

201. As to in-place CPE, the ratepayers' interests are further protected by their opportunity to capture any gains in value through purchase pursuant to the terms of the in-place sale program prescribed by this *Order*. However, as to embedded CPE that is not installed on a customer's premises (hereinafter "inventory CPE"), the ratepayer will not be able to take advantage of the further protection afforded by the transition program, because such CPE is outside the constraints of the in-place sale program. We expect that a large part of the refurbishing expenses incurred in 1983 (and some refurbishing expenses incurred in earlier periods) will have contributed to the value of inventory CPE which will not be subject to the sale program. Thus, despite the fact that refurbishing expenses borne by ratepayers will have contributed to the value of inventory CPE, the ratepayers will not have the opportunity to obtain any gain associated with such CPE, and this gain will be transferred to AT&T's stockholders.

202. We have required in our earlier capitalization review (see para. 176 n.151, (*supra*) that ratepayers should be reimbursed for expenses they have borne that benefit ATTIS. We find here that refurbishing expenses associated with CPE that will be transferred to ATTIS and that is not subject to the sale program should be reimbursed to the ratepayers in a manner consistent with *New CPE I*, 91 FCC 2d at 598–604. This reimbursement amount may be difficult to quantify. To the extent that the BOCs, in the preservation of their own self-interest, have identified and valued equipment to be transferred, we would expect that they are in a favorable position to itemize CPE that will be transferred to ATTIS. On the basis of that itemization, they would be able to determine associated refurbishing expenses. To that extent, we might have found it expedient to require the BOCs to bill AT&T for such expenses. However, we do not wish to risk burdening the administrative resources of either the BOCs or AT&T at a time when their capacities undoubtedly are strained to the limit by the demands of reorganization.

203. In the interest of obtaining an expeditious resolution of this matter, we will assume that all inventory CPE was refurbished during the last year prior to transfer. Further, we will assume that all refurbishing expenses incurred in 1983 were devoted to the inventory CPE which will be transferred to ATTIS. Like the costs of expensed assets discussed in Part XII.B.3., *supra*, we will treat refurbishing expenses as expenditures that create value of precisely one year's duration. Further, we will assume that these expenditures occurred at a uniform rate throughout the year. Thus, as with expensed assets, AT&T should reimburse each of the BOCs for 50 percent of the amount of refurbishing expenses incurred in 1983 by the respective BOCs.

2. *Contingent Liabilities*

204. GTE argues that the capitalization plan fails to reflect "disposition costs." GTE Capitalization Comments at 9–11. Such costs not already discussed in the preceding section include what will be treated here as contingent liabilities. They are: (1) potential tax liability costs (federal, sales, local, state, income, and other); (2) fulfillment of any warranties on CPE disposed of; and (3) customer return credits. Stated generally, each of these types of costs arose as a potential liability of regulated operations. The extent to which these obligations actually come due, however, will not be known until after the detariffing and transfer to ATTIS of the activity which originally gave rise to the potential liability. We must determine whether these types of costs properly are treated as expenses of regulated or unregulated operations.

205. As to tax liabilities, the AT&T Plan of Reorganization divides among AT&T and the BOCs the amount of federal income tax deficiencies (or overpayments) on the basis of each entity's relative contribution to consolidated taxable income as of the effective date of divestiture. AT&T Plan of Reorganization at 187–90, *United States v. AT&T* (filed Dec. 16, 1982). To the extent that the liabilities thus allocated reflect tax timing adjustments, that portion of the liability will be further allocated on the basis of the benefit or detriment of the timing and adjustment. The allocated liabilities will also be further allocated to reflect investment tax credits on the basis of the Plan's assignment of the assets which gave rise to the credit. *Id.* State and local taxes are not explicitly treated but evidently will be assigned on the basis of relative net investment on the effective date of divestiture. *See id.* at 189.

206. AT&T's capitalization Supplement does not discuss the manner in which ATTIS will be assigned contingent tax liabilities. We find that ATTIS should be attributed with contingent tax liabilities arising from pre-transfer events and that these liabilities should be allocated on the same basis as that by which the AT&T Plan of Reorganization assigns contingent tax liabilities between AT&T and the BOCs. This is a fair way of assuring that ATTIS bears liabilities approximately proportionate to the size of the ongoing business which it will receive upon transfer of embedded CPE operations to ATTIS. It is also consistent with the requirements of the MFJ.

207. Similarly, responsibility for fulfillment of the warranties on CPE disposed of should be assigned to ATTIS. These are evidently warranties on CPE sold under regulation by the BOCs but which may be honored after transfer. If we were to view ATTIS as having purchased the ongoing CPE business from the BOCs, absent special consideration, ATTIS probably would have obtained warranty obligations along with other assets and liabilities of the business.

Accordingly, it is fair to require that ATTIS bear expenses incurred in 1984 and thereafter associated with warranties on equipment sold under regulation. This requirement is not intended to affect the manner in which customers will be required to obtain warranty service. We do not seek to prevent customers from obtaining such service from the entity which sold the CPE under regulation. The costs of such service may be billed to ATTIS.

208. Customer return credits evidently are the product of particular states' programs wherein the telephone company is required to offer a specified dollar incentive for customers to return their phone to the company. There appears to be no reason to believe that obligations associated with customer return credits, unlike warranties, are not established with certainty at the moment the customer returns the telephone to the BOC.[159] Accordingly, there is no reason to treat them as a part of the business which ATTIS has "purchased" from the BOCs. Moreover, return credits, unlike refurbishing costs, do not appear to create any benefit which will extend beyond the date of transfer to ATTIS. Because these are state-decreed regulatory programs, the expenses associated with these programs should be treated by the states in a manner consistent with their power to regulate franchised local exchange operations.

3. *Indirect Expenses*

209. Before approval of this supplement, ATTIS, on behalf of AT&T, will have developed finance and data systems which will be needed to convert and transfer records associated with the embedded base. Expenses for these activities, exclusive of loadings for general overhead costs, will be separately recorded on ATTIS's and AT&T's books. AT&T will record expenses for these activities in separate account elements (Budget Decision Packages or "BDPs") which will not be included in license contract billings or as a part of interstate service expenses. AT&T will periodically reimburse ATTIS for these expenses. AT&T will report these expenses in the quarterly and annual ATTIS financial reports required by *Enhanced Services Capitalization Plan Order*, 90 FCC 2d at 430–31. The estimated amount of these pre-approval expenses is $40 million. AT&T Capitalization Supplement at 10–11. AT&T will also invest in physical facilities needed for this work. The facilities will be transferred to ATTIS after the embedded CPE capitalization is approved.

210. California and NATA challenge AT&T's failure to include general overhead costs in its proposed reporting of conversion costs. California Capitalization Comments at 17; NATA Capitalization

[159] This discussion assumes that no state-decreed customer return credit programs may oblige a carrier's unregulated operations to honor such credits.

Comments at 16. AT&T replies that the general overhead costs to which it referred in the Supplement are ATTIS's and not AT&T's. AT&T Capitalization Reply at 34.

211. AT&T's pleadings are not clear on this issue. If AT&T, as well as ATTIS, is directly incurring conversion expense, then a fair allocation of all categories of AT&T's overhead costs should be included in the separate accounts. If such general overhead expenses of AT&T are not attributed in this manner to ATTIS, they may appear in BDPs which are included in license contract billings to the BOCs or become a part of interstate service expense.

212. It appears, however, that all of the work of conversion is being conducted by ATTIS for its own benefit. If so, the omitted overhead will be solely ATTIS's. As a result, the overhead expenses will be absorbed by ATTIS, none of these expenses will appear on AT&T's books, and, consequently, there is no danger that these expenses can be passed on to ratepayers. The details of these matters should be confirmed by the Common Carrier Bureau's ongoing staff audit of *Second Computer Inquiry* implementation.

213. AT&T's capitalization Supplement proposes that ATTIS provide AT&T services for which ATTIS will be reimbursed. These transactions should be compensatory and auditable, and a copy of the contract should be filed with the Commission. AT&T has filed with the Commission copies of contracts between and among AT&T affiliates and the separate subsidiary. These are under review in another proceeding and shortly will be the subject of a staff report. Approval of the means by which AT&T accounts for or files with the Commission transactions between ATTIS and unseparated affiliates is not a condition precedent to approval of AT&T's plans for the financing and operation of the subsidiary. Accordingly, the details concerning the provision of services by ATTIS to AT&T can constitute no bar to approval of AT&T's Supplement to its plan for the capitalization of ATTIS in connection with the transfer of embedded CPE.

XIII. REGULATORY FLEXIBILITY CERTIFICATION

214. We invited interested parties in the *Notice* to comment upon our initial regulatory flexibility analysis. *Notice* at para. 86. Our analysis stated our legal authority for taking action in this proceeding, concluded that our proposed rules would not duplicate, overlap, or conflict with an existing federal rules, and stated the tentative view that this proceeding does not apply to small businesses, as that term is defined in the Regulatory Flexibility Act, 5 U.S.C. §§ 601–612. *Id.* at paras. 87–90. None of the parties filing comments regarding the *Notice* addressed any of these issues.

215. We hereby certify that the Regulatory Flexibility Act is not applicable to the action we are taking in this proceeding. Our action affects the offering of CPE by AT&T, ATTIS, and the BOCs. We find

no reason to alter the tentative view we expressed in the *Notice* that none of these companies is a small business for purposes of the Regulatory Flexibility Act. As we have recently noted in another proceeding, the Act "was apparently designed for the protection of small businesses that are directly subject to administrative rules rather than businesses that are indirectly affected by the results that any rules will produce." *MTS and WATS Market Structure*, CC Docket No. 78–72, Phase I, at para. 369. Although small businesses may be indirectly affected by the results of our actions in this proceeding, no small businesses are directly subject to our action.[160]

XIV. CONCLUSION

216. With our decision in this proceeding we have completed another step along the path of deregulation in the telecommunications industry. We have taken this step as the industry continues to undergo significant and far-reaching changes. These changes—which include the new system of access charges we have established, the divestiture of the Bell System, and the emergence and growth of competition in the long distance market—are reshaping telecommunications in ways which will offer great opportunities to the industry and bring major benefits to consumers.

217. Our action in providing for the removal of AT&T's embedded CPE base from regulated service joins these other changes as a vehicle for significant progress from the perspective of the industry and consumers. Both CPE users and suppliers now will be able to reap the benefits of a competitive marketplace. For consumers, competition will bring a wider variety of choices, improved products, and better service. For carriers, the removal of regulation will enable them to compete in the CPE marketplace without being subject to the artificial restraints and restrictions which often accompany regulatory controls.

218. In taking this step toward deregulation, we have been mindful of the fact that "[p]rogress needs a brakeman, but the brakeman should not spend all his time putting on the brakes."[161] The transition we have structured puts on the brakes to slow the progression toward complete deregulation only to the extent necessary to guard against the dislocations which could result from an abrupt removal of regulation. The detariffing and transfer plan we have established offers ample protection to ratepayers and in-place customers, protects the development and expansion of competition in

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[160] Furthermore, our transitional requirements will protect the interests of small businesses by providing them a meaningful opportunity to make purchase decisions during a full two-year price predictability period governing equipment which they lease.

[161] *A New Dictionary of Quotations* 979 (H. L. Mencken ed. 1960) (quoting Elbert Hubbard).

the CPE marketplace, extends to Bell System investors an opportunity to recover their investment in the transferred embedded base, and permits ATTIS to join the ranks of unregulated CPE competitors without the imposition of unwarranted burdens and restraints.

219. In short, the detariffing and transfer plan has resolved the central questions we posed in the *Notice*. *See Notice* at para. 83. First, our plan provides that AT&T's entire embedded base will be offered for sale to in-place customers. A substantial portion of the embedded base will be covered by national sale prices, while the remainder will be offered for sale on an individual basis upon customer request. Second, the detariffing and transfer plan, in using net book value as a surrogate for economic value, accommodates the interests of ratepayers by giving them an opportunity to capture gains above net book through the requirement that the embedded base, in the aggregate, must be offered for sale at net book value. At the same time, the interests of investors are protected by permitting the embedded base to be valued (for sale price and transfer purposes) on an aggregated basis, thus giving ATTIS sufficient pricing and valuation flexibility to provide investors with an opportunity to recover their investment in the assets being removed from regulated service.

220. Third, sale and lease terms and conditions have been included in the plan to protect in-place customers. We have concluded that the provisions of AT&T's proposed plan for the sale and lease of residence and single-line business CPE, combined with the strength of competition in this market, offer sufficient protection to customers. With regard to multi-line CPE, we have modified AT&T's proposed plan to ensure that in-place customers are sufficiently protected against any steep increase in lease rates and an abrupt transition to a deregulated environment. Finally, we have decided that intrasystem wiring should not be transferred to ATTIS, in part because ATTIS's control over this wiring could have anticompetitive results.

221. Our action in this *Order* brings bifurcation to an end with regard to the Bell System. As we have noted, we will take action with respect to the embedded CPE base of the Independent telephone companies and the record carriers in a subsequent action in this docket. With these actions, we have set the stage for continued progress in the CPE marketplace.

222. We shall require the policies, rules, and requirements established in this *Order* to take effect (with certain exceptions) on the date following the date of the release of this *Order*. We recognize that the Administrative Procedure Act requires the effective date of rules to occur at least 30 days following publication in the *Federal Register*, "except . . . as otherwise provided by the agency for good cause found and published with the rule." 5 U.S.C. § 553(d). We hereby find good cause for an earlier effective date to exist because of

the need for these policies, rules, and requirements to be in place a sufficient time before the divestiture of the Bell System. Such an early effective date will assist in reducing uncertainty currently faced by carriers, in-place customers, and state commissions as they prepare to cope with the post-divestiture period. The industry and consumers need to know what ground rules will apply to the embedded base after divestiture, and the urgency of this need warrants an early effective date for our action in this proceeding.

XV. ORDERING CLAUSES

223. Accordingly, IT IS ORDERED That, pursuant to Sections 4(i), 4(j), 201–205, 213, 218, 220, and 403 of the Communications Act of 1934, 47 U.S.C. §§ 154(i), 154(j), 201–205, 213, 218, 220, and 403, the policies, rules, and requirements set forth herein ARE ADOPTED, effective on the date following the date of the release of this *Report and Order*.

224. IT IS FURTHER ORDERED, That the requirements established in Part XII.B. of this *Report and Order*, relating to CPE associated with NSEP communications systems, shall take effect June 1, 1984.

225. IT IS FURTHER ORDERED, That the proceeding entitled Request for Waiver of Section 64.702(d)(3) of the Commission's Rules and Regulations, File No. ENF 83–38, IS TERMINATED.

226. IT IS FURTHER ORDERED, That the motion for leave to file late comments filed by United States Independent Telephone Association IS GRANTED.

227. IT IS FURTHER ORDERED, That the motion for leave to substitute a corrected page in an original filing filed by the Independent Data Communications Manufacturers Association IS GRANTED.

228. IT IS FURTHER ORDERED, That the substitution of a corrected page in an original filing filed by Western Union IS ACCEPTED, as requested by Western Union.

229. IT IS FURTHER ORDERED, That the late comments filed by the People of the State of California and the Public Utilities Commission of the State of California, ARE ACCEPTED, as requested by California.

230. IT IS FURTHER ORDERED, That the late comments filed by the Public Service Commission of the District of Columbia ARE ACCEPTED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

NOTE: Appendix C may be seen in FCC Dockets Branch, 1919 M St. N.W. Wash., D.C. 20554.

APPENDIX A

Analysis of Tax Issues

I. BACKGROUND: ACCELERATED DEPRECIATION AND INVESTMENT TAX CREDITS

A. *Basic Framework: Normalization v. Flow-Through Accounting*

1. The Internal Revenue Code (the "Code") provides for accelerated methods of depreciation and investment credits to encourage businesses to make investments in productive assets. Accelerated methods of depreciation permit a company to take larger depreciation deductions in the early years of an asset's life as compared with straight-line depreciation. However, the total amount of depreciation which may be taken under either method may not exceed the cost of the asset. Thus, under accelerated depreciation the larger deductions in the early part of the asset's life are offset by smaller deductions in the latter part of its life. This produces a tax deferral, not a permanent tax savings, because the lower taxes in the early years are offset by higher taxes in the later years. This tax deferral is, of course, of benefit to the company because for the period of deferral it has the use of those funds.

2. ITCs, by contrast, represent a permanent tax savings. A company is able to deduct a certain percentage of the cost of qualified property from its tax liability in the year in which it places the property in service. Absent an occasion for recapture, the credit does not have to be repaid to the Treasury.

3. Regulated public utilities, including the BOCs, are entitled to use accelerated methods of depreciation and ITCs to reduce their tax liability only under certain conditions set out in the Code concerning the accounting and regulatory treatment of the resulting benefits. There are two basic methods a public utility could conceivably use in accounting for those benefits on its regulated books—"normalization" and "flow-through." Under normalization accounting, those tax benefits are not fully taken into account for ratemaking purposes in the year in which the utility receives them but are spread over the life of the asset (as defined for regulatory depreciation purposes) to which the benefits relate. Under flow-through accounting, on the other hand, those benefits are passed on immediately to the utility's customers. Under the Code, the BOCs are eligible to take accelerated depreciation and ITCs only if the resulting tax benefits are normalized for ratemaking purposes.[1]

4. Normalization with respect to accelerated depreciation is achieved by treating the utility's income tax expense (which is included in the utility's cost of

[1] The question whether to use a normalization or flow-through approach to account for the tax benefits of accelerated depreciation and ITCs is not limited to regulated companies. A nonregulated company has to account in some fashion for such tax benefits on its financial statements, and normalization and flow-through are the two basic techniques for doing so. Under generally accepted accounting principles, normalization is required with respect to accelerated depreciation and recommended with respect to ITCs. *See* AICPA Accounting Principles Board, Opinion No. 11 (accelerated depreciation) and Opinions No. 2 and No. 4 (investment tax credits). However, while the use of one or the other of these methods will affect the reported operating results of a nonregulated company (*e.g.*, its reported earnings), it will not affect, at least directly, the prices such a company is able to charge for its products or services. A regulated utility's rates, on the other hand, are directly affected by its revenue requirements, which are in turn directly affected by the accounting treatment accorded the tax benefits of accelerated depreciation and ITCs.

service) not as the amount it actually paid in taxes, but as the amount it would have paid had it used its book method of depreciation to determine its income tax liability. Thus, normalization involves the use of an accelerated depreciation method for computing actual income tax liability and a less accelerated or straight-line method for computing income tax expense for book or ratemaking purposes.[2]

5. The difference between the taxes the utility actually pays and the tax expense it shows on its regulated books is credited to a deferred tax account or reserve. At any given time, this reserve represents the accumulation of tax reductions that have resulted from the excess of accelerated depreciation over straight-line or other book depreciation over the years. These accumulated tax reductions represent cost-free capital to the utility. While it will eventually have to repay those funds to the Treasury in the form of higher taxes,[3] it has the interest-free use of those funds until that repayment occurs. For this reason, the Code permits deferred tax reserves to be deducted from a utility's rate base, and we require utilities under our jurisdiction to make that rate base adjustment.

6. With respect to ITCs, normalization is achieved by amortizing the credits over the life of the property that gave rise to them rather than treating the credits as reductions in tax expense in the year in which they are received.[4] In this fashion, the tax benefits of the ITCs are flowed through to ratepayers, but only at the same rate that the associated asset is depreciated. (For this reason this normalization technique is sometimes referred to as "ratable flow-through.") The amount of the ITCs not immediately recognized for ratemaking purposes as a reduction in tax expense is credited to an unamortized ITC account, which at any given time represents the accumulated ITCs taken by the utility on its tax returns but not yet flowed through to ratepayers. Under this normalization approach, no reduction is made in the utility's rate base on account of the ITCs.[5]

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[2] Under a flow-through approach, the taxes actually paid by the utility (using accelerated depreciation) would be treated as the utility's tax expense for ratemaking purposes.

[3] The utility will not be able to pass on those subsequent, higher taxes to its ratepayers because its recoverable income tax expense will again be based on its book income, which in the later years of an asset's life will be smaller than taxable income (reflecting the fact that by that time depreciation charges for book purposes exceed those for tax purposes).

[4] Thus, under the normalization approach, the tax expense included in the utility's cost of service is not reduced immediately by the actual tax savings realized by the utility as the result of its taking the credit but is reduced each year of the associated asset's useful life by the "normalized" amount of the credit. For example, assume a utility purchased a piece of equipment for $1,000 that had a useful life (for regulatory depreciation purposes) of 10 years. By taking the ITC on the equipment, the utility would be able to realize an immediate tax savings of 10 percent of the purchase price (the current ITC percentage rate) or $100. By using normalization accounting, it would spread that $100 tax savings for ratemaking purposes over the life of the asset by reducing tax expense by $10 per year for the next 10 years.

[5] There is a second type of normalization permitted under the Code that involves reductions in rate base in the amount of the ITCs, but no reductions in cost of service. I.R.C. § 46(f)(1). However, the Bell System companies utilize the normalization approach outlined in the text. *See* discussion at para. 19 n.35, *infra*.

B. *Legislative and Regulatory History*

1. *Accelerated Depreciation*

7. Accelerated depreciation was first made generally available to taxpayers in the Internal Revenue Code of 1954.[6] The House and Senate Committee reports accompanying the Code indicate that the Congressional purpose in providing for accelerated depreciation was to encourage businesses to maintain and increase their investment in productive assets such as plant and equipment.[7]

8. Regulated public utilities were among the taxpayers to whom the benefits of accelerated depreciation were extended. The Code did not specify any particular regulatory treatment of accelerated depreciation, and the approaches of regulatory commissions varied. Some commissions, including this Commission, required the utilities under their jurisdiction to flow through the tax benefits of accelerated depreciation immediately to ratepayers, while others permitted those benefits to be normalized and in effect flowed through gradually.[8]

9. In 1969 Congress acted to limit what it viewed as an undesirable trend on the part of regulatory commissions toward requiring the flow through of the tax benefits of accelerated depreciation.[9] Flow-through ratemaking meant that the deferred taxes derived from accelerated depreciation were not available to utilities for investment purposes. Furthermore, Congress was concerned that when flow-through accounting was used there was a double loss of tax revenues—first, from the direct effect of accelerated depreciation, and second, from the indirect effect of reduced utility rates and profits, which led to reduced utility income taxes.[10]

10. In response to these perceived problems, Congress in the Tax Reform Act of 1969 added section 167(1) to the Code,[11] which in effect froze the status quo by prohibiting any more utilities from adopting flow-through accounting. The Act provided that those utilities then using accelerated depreciation and flow-through accounting could continue to do so; utilities not using flow-through, as well as utilities not using accelerated depreciation at all, could thereafter use accelerated depreciation only if they used a normalization method for accounting and ratemaking purposes.

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[6] Act of August 16, 1954, ch. 736, 68A Stat. 51, 26 U.S.C. § 167. *See* Kiefer, *Accelerated Depreciation and the Investment Tax Credit in the Public Utility Industry: A Background Analysis*, The Nat'l. Regulatory Research Inst., Occasional Paper No. 1, 15–16 (1979) (hereinafter *Kiefer*).

[7] *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 24 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 26 (1954).

[8] *See Keifer* at 23–24; Joint Comm. on Taxation, Report to House Comm. on Ways and Means, "Description of H.R. 3165 and H.R. 6806 Relating to Accounting Treatment of the Investment Tax Credit and Accelerated Depreciation for Public Utility Ratemaking Purposes" 5–6 (1980).

[9] Congress found that "[a]bout half the regulatory agencies require that utilities that use accelerated depreciation for tax purposes 'flow through' the resulting reduction in Federal income taxes currently to the utilities' customers." H.R. Rep. No. 91–413 (Part 1), 91st Cong., 1st Sess. 131–32 (1969). And it found the movement toward flow-through accounting was increasing and noted that some agencies were imputing accelerated depreciation to utilities that did not use it in order to reduce utility rates in the amount of the imputed tax deferrals. *See id.*; S. Rep. No. 91–552, 91st Cong., 1st Sess. 171–72 (1969).

[10] *Id.*

[11] Tax Reform Act of 1969, Pub. L. No. 91–172, Title IV, § 441 (1969), enacting I.R.C. § 167(1).

11. Since the Bell System companies had never taken accelerated depreciation up through 1969,[12] they could begin using accelerated depreciation in the post-1969 period only if they normalized the resulting tax deferrals for purposes of their regulatory accounts and ratemaking. In 1970, in response to these revisions in the tax law, we amended our rules to permit normalized treatment of the tax benefits of accelerated depreciation.[13] The Bell System companies began taking accelerated tax depreciation that same year.[14]

2. *Investment Tax Credit*

12. The investment credit was added to the Code by the Revenue Act of 1962.[15] The Act provided a credit equal to a percentage (3 percent for public utilities, 7 percent for other taxpayers) of the cost of acquiring new depreciable property, such as plant and equipment, which could be applied to the taxpayer's income tax liability in the year in which the property was put into service. The purpose of the credit was to stimulate investment by "reduc[ing] the net cost of acquiring new equipment . . . [thereby] increasing the earnings of new facilities over their productive lives and increasing the profitability of productive investment."[16]

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[12] During that period, the Bell System companies used straight-line depreciation for tax as well as ratemaking purposes on the ground that it was not in their best interests to use accelerated depreciation under the rules of many regulatory commissions (including the Commission), which prohibited normalization of the resulting tax benefits. *See* W. Bolter & D. Irwin, *Depreciation Reform, A Crucial Step in Transforming Telecommunications to a Free Market* 187 (1980) (hereinafter *Bolter & Irwin*).

[13] *See* § 31.3–32 of the Commission's Rules, adopted 35 Fed. Reg. 11240 (1970) as amended 40 Fed. Reg. 52726 (1975). Prior to the formal adoption of those amendments, the Chief of the Common Carrier Bureau had issued an order waiving certain sections of Part 31 of the Rules, so as to permit normalization accounting retroactive to January 1, 1970. Order No. 45115, adopted Feb. 26, 1970.

[14] *Bolter & Irwin* at 188; AT&T Response to Bureau Letter at 25.

[15] Pub. L. No. 87–834, 76 Stat. 960 (1962).

[16] S. Rep. No. 1881, 87th Cong., 2d Sess. 11–12 (1962). *See* H.R. Rep. No. 2508 (Conference Report), 87th Cong., 2d Sess. 14 (1962). Interestingly, AT&T opposed the enactment of the credit on the grounds that it would not in fact provide any stimulation for new investment, but would only result in an unnecessary loss of tax revenues for the Treasury. *See* Revenue Act of 1962, Hearings on H. R. 10650 Before the Senate Comm. on Finance, 87th Cong., 2d Sess. 897–902 (1962) (statement of Alexander L. Stott, Vice President and Comptroller of AT&T). Mr. Stott summarized AT&T's objections to the proposed credits as follows:

> Since the purpose of the investment tax credit is to promote construction and growth, the question is whether it would have that result. As far as the Bell System Companies are concerned, it will not. . . . We have been able, under sound regulation, to obtain from investors the additional amount of new capital required to carry on our construction of new facilities. Therefore, we can see no justification for using tax moneys to help finance our expansion.

Id. at 897. AT&T's views on the investment credit have apparently changed over the years. *See* Hearings Before the Oversight Subcomm. of the House Comm. on Ways and Means, 96th Cong., 1st Sess. (1979) (Statement of Robert N. Flint, Vice President and Comptroller of AT&T):

> The provisions of the Code concerning investment credit . . . have reduced the severity of our problems of raising capital. They have enhanced our ability to raise equity for balanced financing; our credit rating is not now in jeopardy; and

13. The 1962 Act did not specify any particular regulatory accounting treatment for the tax savings realized by public utilities from their use of ITCs. In 1963 we held that utilities under our jurisdiction must flow through ITCs to operating income (by treating them as reductions in tax expense) in the year in which the credits were taken for tax purposes, rather than spread them over the life of the property giving rise to the credits.[17] Congress in effect abrogated this decision in the Revenue Act of 1964,[18] which provided that no federal regulatory agency could require that ITCs associated with public utility property be flowed through to income more rapidly than ratably over the useful life of the property.[19] The Committee reports in both Houses of Congress emphasized that the purpose of ITCs was to stimulate investment by reducing the net cost of acquiring depreciable assets and that the flow-through accounting treatment of the credits required by some regulatory agencies (specifically mentioning the Commission) subverted that purpose.[20] Shortly thereafter we amended our rules to permit normalized treatment of ITCs in a manner consistent with the requirements of the 1964 Act.[21]

14. Subsequently, Congress repealed the investment credit provisions of the Code in 1969,[22] and then restored them in 1971.[23] The 1971 Act extended the prohibition on use of flow-through accounting to state, as well as federal, regulatory agencies by providing that a utility would be ineligible for the credits if the resulting tax savings were passed through to ratepayers in other than a normalized manner as set out in the statute.[24] The Congressional intent in restricting flow-through treatment of investment credits was twofold. First, as in 1964, Congress was concerned that flow-through was inconsistent with the purpose of the credit, which was to provide an incentive for investment and not to "stimulate consumption of any particular type of product or service"—the result if credits were used simply to lower utility rates.[25] Second, as with accelerated depreciation, Congress was concerned that immediate flow-through of ITCs would double the associated tax revenue loss through the lowering of utility taxable income.[26]

15. Finally, the 1971 Act increased the allowable credit for public utilities to 4

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the greater financing flexibility available to us has enabled us to serve the country's expanding communications needs.

[17] *See* Amendment of Parts 31 and 35 of the Commission's Rules Concerning Accounting for Investment Credits Made Available by the Revenue Act of 1962, Dkt. No. 14850, Report and Order, 50 P.U.R.3d 159 (1963).

[18] Pub. L. No. 88–272, 78 Stat. 19 (1964).

[19] *Id.* § 203(e).

[20] H. R. Rep. No. 749, 88th Cong., 1st Sess. 36–37 (1963); Sen. Rep. No. 830, 88th Cong., 2d Sess. 42–43 (1964) (The Commission policy "is clearly contrary to the intent of Congress . . . and as a result this bill contains a provision to the effect that it was and is not Congress' intention that the Federal regulatory agencies require the benefit of the investment credit to 'flow-through' in this manner.").

[21] *See* Amendments of Parts 31 and 35 of the Commission's Rules Concerning Accounting for Investment Tax Credits Made Available by the Revenue Act of 1962, Dkt. No. 14850, Report and Order Upon Reconsideration, 29 Fed. Reg. 6012 (1964). The provisions for normalized accounting treatment of ITCs for Class A and Class B telephone companies may be found at Sections 31.174 and 31.304 of the Commission's Rules.

[22] Tax Reform Act of 1969, Pub. L. No. 91–172, 83 Stat. 487 (1969). Congress' concern in 1969 appears to have been that the investment credit, by stimulating spending and reducing tax revenues (and thereby increasing budget deficits), was contributing to inflationary forces then being felt in the economy. *See Keifer* at 23.

[23] Revenue Act of 1971, Pub. L. No. 92–178, 85 Stat. 497 (1971).

[24] *Id.* § 105(c), adding Section 46(e) (now Section 46(f)) to the Code.

[25] H. R. Rep. No. 92–533, 92d Cong., 1st Sess. 24 (1971).

[26] *See id.*; Sen. Rep. No. 92–437, 92d Cong., 1st Sess. 36 (1971).

percent. This percentage was subsequently increased to 10 percent, first temporarily in 1975,[27] and then permanently in 1978.[28]

C. *Current Statutory and Regulatory Provisions*

1. Accelerated Depreciation

16. The provisions of the Code governing the use of accelerated depreciation by public utilities are contained in Sections 167(1)[29] and 168(e)(3).[30] As applied to the Bell System companies, Section 167(1) provides that accelerated methods of depreciation may be used only if those companies use "a normalization method of accounting," which requires them, if they use different depreciation methods for tax and ratemaking purposes, to "make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation."[31]

17. Treasury regulations specify that the amount of federal income tax deferral that must be reflected in that reserve is the difference between the tax liability the taxpayer would have incurred if it had used its book method of depreciation for tax purposes and the tax liability it actually incurred.[32] The regulations also provide that the deferred tax reserve may be used to reduce the utility's rate base for ratemaking purposes but the amount of the reduction in any period cannot exceed "the amount of such reserve . . . for the period used in determining the [utility's] tax expense in computing cost of service in such ratemaking."[33]

18. The Bell System companies, including the BOCs, use straight-line depreciation for ratemaking purposes. Thus, the BOCs are eligible to use accelerated methods of depreciation for tax purposes only if they use a normalization method of accounting as provided in Section 167(l). The Commission's rules provide for such normalized accounting in connection with accelerated depreciation.[34]

2. *Investment Tax Credits*

19. The restrictions on the flow-through treatment of ITCs by public utilities

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[27] Tax Reduction Act of 1975, Pub. L. No. 94–12, 89 Stat. 27 (1975).

[28] Revenue Act of 1978, Pub. L. No. 95–600, 92 Stat. 2763 (1978).

[29] Section 167(l) applies to depreciation taken on "public utility property," which is defined in section 167(l)(3)(A) as "property used predominantly in the trade or business of the furnishing or sale of . . . (iii) telephone services . . . if the rates for such furnishing or sale . . . have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any state or political subdivision thereof." The embedded CPE has clearly been "public utility property" for the purposes of this Section.

[30] Section 168, which was added to the Code by the Economic Recovery Tax Act of 1981, Pub. L. No. 97–34, 95 Stat. 172 (1981), provides for an "accelerated cost recovery system" (ACRS), which allows taxpayers to use accelerated rates of depreciation and shorter useful lives for their post-1980 property than had been permitted previously. Section 168(e)(3), in terms that generally parallel those of Section 167(l), requires that public utilities normalize any tax benefits realized from their use of ACRS.

[31] I.R.C. §§ 167(1)(2), 167(1)(3)(G)(ii).

[32] Treas. Reg. § 1.167(1)-1(h)(1)(iii).

[33] Treas. Reg. § 1.167(1)-1(h)(6)(i).

[34] Section 31.3–32 of the Commission's Rules. *See* Amendment of Part 31 and Part 33 of the Commission's Rules To Provide for Deferral Accounting for Income Tax Differentials Occasioned by the Use of Accelerated Depreciation for Income Tax Purposes, Dkt. No. 18828, Report and Order, 35 Fed. Reg. 11237 (1970); *see also* 40 Fed. Reg. 52725 (1975).

are now contained in Section 46(f) of the Code. The provisions applicable to the Bell System companies are in Section. 46(f)(2),[35] which provides that no credit shall be allowed with respect to any public utility property[36] if (1) the taxpayer's cost of service for ratemaking purposes is reduced by more than a "ratable portion" of the credit; or (2) the taxpayer's rate base is reduced by any portion of the credit. The statute further provides that the "ratable portion" of the credit that is permitted to be passed through to customers is to be determined on the basis of "the period of time used in computing depdepreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account."[37] Thus, the ITC may be passed through to ratepayers in the form of reduced tax expense (and lower rates), but only over the useful life of the property producing the credit.

II. PROPOSED TRANSFER OF DEFERRED TAX RESERVES AND UNAMORTIZED INVESTMENT TAX CREDITS FROM BOCs TO ATTIS

A. *Basic Position*

20. The principal question in this proceeding with respect to both deferred tax reserves and unamortized ITCs is whether those accounts should be transferred from the BOCs to ATTIS together with the associated CPE. As noted, we proposed in the *Notice* that the deferred tax reserves be transferred to ATTIS but that the unamortized ITCs remain with the BOCs.

21. As noted in Part IX of the accompanying *Report and Order*, we now agree with a number of the commenters that under the normalization approach to accounting for the tax benefits of both accelerated depreciation and ITCs, as provided in the Code, our rules, and generally accepted accounting principles, there is a direct

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[35] Section 46(f) of the Code actually provides a utility with three options for accounting for the investment credit. Under the first option, the credit may not be flowed through to income (*i.e.*, used to reduce the company's cost of service) but may be used to reduce the company's rate base, provided that such reduction is restored no less rapidly than ratably over the useful life of the asset. I.R.C. § 46(f)(1). The second option, described in the text, is in a sense the mirror image of the first option: it permits the credit to be flowed through to income (but not more rapidly than ratably) and prohibits any adjustment to rate base. I.R.C. § 46(f)(2). The Bell System companies have elected this second option. The third option permits immediate flow-through of the credit, but is available only to those "grandfathered" utilities that under Section 167(1)(2)(C) are eligible to flow through the tax savings from accelerated depreciation. I.R.C. § 46(f)(3). The Bell System companies are not among those grandfathered companies, and, hence, were not eligible for this flow-through option. *See* paras. 10–11, *supra*.

[36] "Public utility property" is defined in Section 46 as:

> [P]roperty used predominantly in the trade or business of the furnishing or sale of . . . (iii) telephone service . . . if the rates for such furnishing or sale . . . have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

I.R.C. § 46(c)(3)(B), incorporated by reference in I.R.C. § 46(f) (5)(A). The embedded CPE has clearly been "public utility property" for the purposes of this Section.

[37] I.R.C. § 46(f)(6).

and continuing relationship between that give rise to those benefits and the resulting deferred tax reserve and unamortized ITC accounts.[38] Under normalization those accounts come into being as a result of the taxpayer's investment in those assets and are used to reduce the costs associated with providing service with those assets over their useful lives. It follows, in our view, that as a general proposition deferred tax reserves and unamortized ITC accounts should ordinarily not be separated from the underlying assets. However, some commenters have suggested, in effect, that the transfer of embedded CPE from the BOCs to ATTIS is not an ordinary event and that certain considerations, particularly the fact that the transfer will be from a regulated to an unregulated entity, render it inappropriate in this case for the deferred tax reserves and unamortized ITC accounts to move with the associated assets.[39] Indeed, it was such a concern that underlay our tentative view expressed in the *Notice* that since the ITCs arose under regulation, they should remain under regulation and be flowed through to ratepayers even after the associated CPE has been removed from regulation.

22. There appear to be three principal sets of concerns raised in the *Notice* and the comments on the question whether deferred tax and unamortized ITC accounts should be transferred with the embedded CPE.

(1) Would a transfer of those accounts be equitable for ratepayers of the BOCs?

(2) Would retention of those accounts by the BOCs for continued use in ratemaking violate the applicable provisions of the Internal Revenue Code and result in the BOCs forfeiting their eligibility for accelerated depreciation and investment credits?

(3) Would transfer of those accounts confer unfair competitive advantages on ATTIS in the CPE marketplace?

In the following sections we address these concerns, first for deferred tax reserves, and then for ITCs.

B. *Deferred Tax Reserves*

1. *Ratepayer Equity*

23. Both the proponents and opponents of transferring the deferred tax reserves to ATTIS appear to agree with the *Notice* that, "[i]n effect, the taxes deferred because of timing differences [attributable to accelerated depreciation] represent cost-free capital to the company."[40] But they differ as to the proper characterization of the source of this cost-free capital, and these differences are reflected in their arguments on whether transferring the reserves from the BOCs would be equitable for ratepayers of those companies. Those who favor keeping the reserves with the BOCs argue that deferred taxes represent overpayments of taxes by ratepayers and, therefore, are in effect interest-free loans from ratepayers to the company.[41] It follows, of course, from this characterization that as a matter of equity such overpayments or loans should be repaid to the persons who supplied them, *i.e.*, ratepayers.[42]

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[38] *See* AT&T Reply Comments at 41–50; Arthur Andersen Direct Comments at 2–4; SNET Direct Comments at 18–21; GTE Direct Comments at 35–38.

[39] *See, e.g.*, NATA Direct Comments at 29–39; NATA Reply Comments at 39–50; California Direct Comments at 10–19; CBEMA Direct Comments at 5–6; CBEMA Reply Comments at 7–8.

[40] Notice at para. 53.

[41] *See, e.g.*, NATA Direct Comments at 30–32; CBEMA Direct Comments at 5.

[42] To illustrate this position, deferred tax reserves for utilities may be analogized to "budget plans" for home heating fuel under which a customer pays a flat monthly charge that is higher in warm months and lower in cold months than the cost of

24. Those who support the transfer of the deferred tax reserves from the BOCs argue that those reserves do not represent ratepayer-supplied capital but capital supplied by the United States Treasury; *i.e.*, it is the Treasury that is the source of the cost-free "loan" to the BOCs.[43] According to this view, ratepayers have simply paid the "normal" amount of taxes reflecting "normal" depreciation, but Congress has deferred the collection of a portion of those taxes in order to encourage business behavior that it considers to be in the national interest. It follows from this characterization that ratepayers have not made any "overpayments" (rather, the Treasury has been underpaid). The Treasury loan will be paid back by ATTIS and not the BOCs, and ratepayers will not need the deferred tax reserves to prevent their rates from increasing as a result of that repayment.[44]

25. Each of these two competing characterizations of the deferred tax situation has some facial validity. Only one, however, seems consistent with Congress' view of what it was doing in providing for accelerated depreciation for public utilities. It seems reasonably clear from both the structure of the Code provisions governing accelerated depreciation and the legislative history of those provisions that Congress thought that it was making funds available from the United States Treasury to public utilities. There is no sense in that history that Congress viewed accelerated depreciation as a means of requiring ratepayers to supply cost-free capital through "overpayments" of taxes to their utility companies. Rather, the Treasury was directed

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fuel actually consumed. For example, let us assume that the customer actually uses $50 of fuel per month in the six warm months and $150 worth of fuel in the six cold months, but pays a flat rate of $100 per month. Obviously, over the course of the year the total "overpayments" in the warm months balance out the "underpayments" in the cold months. But if after the six warm months the customer and fuel supplier terminate their business relationship, should the customer be able to recover the $300 worth of "overpayments" he made to his supplier? The answer would seem to be "yes." This is similar, it would be argued by those opposed to transfer of the reserves, to the deferred tax situation. Ratepayers have made overpayments to the BOCs in anticipation of recovering those amounts at some later time, which recovery would be aborted by the transfer of the deferred tax reserves from the BOCs to ATTIS.

[43] *See, e.g.*, Arthur Andersen Direct Comments at 3; AT&T Reply Comments at 46–47.

[44] The comparison of the deferred tax situation to heating fuel "budget plans" (discussed at para. 23 n.42, *supra*) can be modified slightly to illustrate this characterization of the reserves. Let us assume that (1) the customer who pays $100 per month to his supplier actually uses $100 of fuel per month (instead of using either $50 or $150 of fuel); (2) the supplier purchases the fuel from a wholesaler for the same $100 per month; and (3) the supplier has a loan arrangement with his wholesaler under which he pays the wholesaler $50 per month for the first half of the year and $150 per month for the second half of the year. If after the first half of the year the customer and supplier terminate their business relationship, is the customer entitled to a refund of the $300 he paid the supplier, but the supplier did not pass on the wholesaler? The answer would seem to be "no." The customer got what he paid for, and the supplier will have to repay the $300 to the wholesaler. This is similar, it could be argued, to the deferred tax situation. The Treasury has made a "loan" to the BOCs by deferring the payment of taxes owed to it. Ratepayers have paid no more to the BOCs than they would have in the absence of this "loan," and have no liability to repay the loan to the Treasury. In this sense, ratepayers have no more of an equitable claim to have the "loan" paid to them in the form of lower rates than would the fuel customer have an equitable claim to the return of the $300 in the situation described above.

to defer the collection of taxes owed to it in order to encourage business investment in productive capital assets.[45] Indeed, the requirement that utilities normalize the tax benefits of accelerated depreciation appears to reflect Congress' view that those taxpayer-supplied funds should not simply be passed on to ratepayers.[46] Thus, at least in Congress' view, the deferred tax reserves resulting from accelerated tax write-offs are in the nature of loans from the Treasury, not loans from ratepayers, and transfer of those reserves with the associated assets (and the associated tax liabilities) would not seem to involve taking from ratepayers an opportunity to recover anything to which they have an equitable claim.

26. Furthermore, it does not appear to us that ratepayers have in some sense been disadvantaged by the normalized treatment of accelerated depreciation (as some opponents of transfer imply)[47] or would be unfairly treated by the transfer of the reserves. First, since the deferred tax reserves were excluded from the BOCs' rate base, ratepayers enjoyed lower rates as a result of the cost-free capital the BOCs obtained by taking accelerated depreciation.[48] Such lower rates are comparable to the benefits of accelerated depreciation one would expect to see passed on to customers in unregulated industries as the result of competition.[49] There is nothing in the accelerated depreciation provisions of the Code or their legislative history that suggests that Congress intended this benefit for utility ratepayers to extend past the period in which the assets themselves are owned by the utilities.[50] Nor does there seem to be a compelling equitable extra-statutory claim that ratepayers should continue to have the benefits of rate base reductions associated with embedded CPE after the CPE itself is removed from those rate bases.

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[45] *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 24 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 26 (1954).

[46] H.R. Rep. No. 91–413, 91st Cong., 1st Sess. 132–33 (1969); Sen. Rep. No. 91–552, 91st Cong., 1st Sess. 172 (1969).

[47] *See* NATA Direct Comments at 30–32.

[48] Far from viewing the normalization requirements for utilities as imposing extra costs on ratepayers, Congress viewed the provisions permitting deferred tax reserves to be deducted from rate bases as a means of ensuring that ratepayers directly shared in the benefits of those funds that it—Congress—had made available to utility companies. Sen. Rep. No. 91–552, 91st Cong., 1st Sess. 173 (1969); H.R. Rep. No. 92–533, 92d Cong., 1st Sess. 25 (1971).

[49] *See Keifer* at 97–98:

> Accelerated depreciation amounts to an interest-free loan from the treasury to the benefitting company; the principal of the loan is received in installments during the early years of the useful life of the company's assets as accelerated depreciation exceeds straight line depreciation and is paid back in the later years when accelerated depreciation is less than straight line. The value of this interest-free loan to the company is the imputed "interest" on the outstanding principal of the "loan" over the life of the related assets. The receipt of this interest-free loan reduces the cost of owning the company's capital assets by the amount of the imputed interest. In a competitive industry competition will force the company to pass this capital cost reduction on to customers in lower prices. This then is the result which normalization of accelerated depreciation should achieve in the regulated industries. Normalization of accelerated depreciation with the deferred tax account excluded from the rate base does achieve this result. The exclusion of the deferred tax account from the rate base accomplishes the objective of passing on to customers the imputed interest on the interest-free Treasury loan through lower utility rates.

[50] Indeed, it appears that the Code provisions may not permit benefits from accelerated depreciation to continue to flow to ratepayers when they do not bear the associated costs of the assets. *See* paras. 28–29, *infra*.

27. Second, as alluded to earlier, were the BOCs to retain the CPE, the associated deferred tax reserves would be used in the ratemaking process to offset the higher taxes that would come due in the latter part of the assets' lives. The reserves effectively protect ratepayers from higher rates when, through those higher tax payments, the "loan" from the Treasury is repaid by the BOCs. But the BOCs will rid themselves of the liability for those higher taxes by transferring the assets to ATTIS, and the corresponding protection from higher rates provided by the reserves will no longer be needed. Use of the deferred tax reserves to offset other tax expense incurred by the BOCs completely unrelated to the accelerated depreciation taken on the transferred assets,[51] while it would result in lower utility rates, does not present a particularly compelling case on equity grounds.

2. *Normalization Requirements of Internal Revenue Code*

28. AT&T argues that the BOCs would lose their eligibility to claim accelerated tax depreciation if they were to retain the deferred tax reserves after transferring the associated assets to ATTIS.[52] The Code and the regulations do not appear to address this question directly. It is clear, however, that Section 167(1) of the Code and the associated regulations condition a public utility's eligibility for accelerated depreciation on the use of "a normalized method of accounting" and that such normalization contemplates making adjustments to a deferred tax account in connection with the ongoing depreciation of the associated assets.[53] In providing those normalization requirements, neither Congress nor the Department of the Treasury appears to have had in mind a situation in which one taxpayer holds the assets and takes the associated depreciation expenses while another taxpayer holds the associated deferred tax reserves and uses them to reduce its rate base or cost of service. To the contrary, the Code and the regulations seem to assume a continuing relationship between, and a system of complementary adjustments to, a utility's deferred tax reserves and its depreciation expense, tax expense, and rate base. The BOCs' retention and continued application of the deferred tax reserves to reduce rates after the associated CPE is transferred does not seem fully consistent with this overall statutory and regulatory scheme for accounting for the tax benefits of accelerated depreciation taken by public utilities.[54]

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[51] This would seem to be the treatment of those reserves contemplated by at least one of the proponents of leaving the reserves with the BOCs. *See* NATA Direct Comments at 39 n.*.

[52] AT&T Reply Comments at 47; AT&T Response to Bureau Letter at 28 n.*.

[53] *See* I.R.C. §§ 167(1)(2), 167(1)(3)(G); Treas. Reg. 1.167(a)-11(b)(6); 1.167(a)-12(a)(4); 1.167(1)–1.

[54] For example, AT&T argues that the continued reduction of BOC rate bases in the amount of the deferred tax reserves associated with the transferred CPE would be inconsistent with the requirements of Treas. Reg. 1.167(1)–1(h)(6)(i) and Section 168(e)(3) of the Code. Treas. Reg. 1.167(1)–1(h)(6) provides:

> [A] taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under Section 167(1) which is excluded from the base to which the taxpayers rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's tax expense in computing cost of service in such ratemaking.

AT&T argues that if a BOC's deferred tax reserves were not reduced to reflect the transfer of the embedded CPE to ATTIS, this regulation would be violated because the amount excluded from the BOC's rate base would not be consistent with the calculation of its tax expense for cost of service purposes. AT&T Reply Comments at 47–48 n.***.

29. Thus, while this may not be the open and shut case AT&T claims, the basic incompatibility of the structure and language of the relevant provisions of the Code and regulations with a situation in which the assets and associated reserves are separately held and accounted for suggests that those provisions would be violated, and the BOCs' eligibility to take accelerated depreciation placed in jeopardy, if the BOCs were to retain the deferred tax reserves.

3. *Possible Competitive Advantages for ATTIS*

30. Some commenters argue that transfer of the deferred tax reserves to ATTIS would bestow unfair competitive advantages on that company in the CPE marketplace.[55] In response, AT&T argues that the deferred tax reserves are not pools of cash or capital that ATTIS can invest or use to finance or subsidize any of its operations, but bookkeeping entries that will allow it to reflect more accurately the results of its operations on its financial statements.[56]

31. ATTIS will be liable for the deferred taxes that come due as the result of the BOCs having depreciated the CPE at a faster rate for tax purposes than for book purposes and "normalized" the difference. These taxes will be payable in the latter part of the life of the CPE when depreciation charges for book purposes exceed those available for tax purposes or when CPE whose book basis exceeds its tax basis is sold.[57]

Section 168(e)(3) of the Code provides that a taxpayer does not use a normalization method of accounting if it uses inconsistent estimates or projections, which include:

> [A]ny procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes . . . unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

AT&T argues that after transfer of the CPE the BOCs' tax and depreciation expenses will be determined without regard to those assets and that if the deferred tax reserve is not similarly adjusted to reflect the transfer, the consistency requirements of this Section will be violated. AT&T Reply Comments at 47–48 n.***

NATA suggests that any deferred tax reserves remaining with the BOCs could be returned to ratepayers through amortization of the reserves against future tax expense of the BOCs. NATA Direct Comments at 39 n.*. AT&T does not respond directly to this suggestion, but Treas. Reg. 1.167(1)–1(h)(2)(i), which governs adjustments to deferred tax reserves, provides:

> With respect to any account, the aggregate amount allocable to deferred tax under Section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of prior use of different methods of depreciation under subparagraph (1)(i) of this paragraph.

Under NATA's plan this regulation might be violated since there would be reductions made to the reserve (to reduce BOC tax expense for ratemaking purposes) that did not reflect increased federal taxes resulting from a prior use of accelerated depreciation.

[55] *See* California Direct Comments at 12; CBEMA Reply Comments at 8; NATA Reply Comments at 49 (transfer of the deferred tax reserves with the associated CPE "would transfer the benefit of the earnings on that prepaid tax liability and would confer an undue competitive advantage upon [ATTIS].")

[56] *See* AT&T Reply Comments at 46; AT&T Response to Bureau Letter at 27–28, 32–33.

[57] In the case of such a sale, the gain for tax purposes will exceed that for financial

These taxes will be paid by ATTIS.[58] The deferred tax reserves, if transferred, will not provide any cash to make these payments to the Treasury, but they will provide ATTIS with an accounting entry against which to charge those payments rather than charge them against income.[59] In our view, this is an appropriate use of those reserves. It is not clear, in any event, how these reporting and accounting factors would bestow an unfair advantage on ATTIS vis-a-vis other CPE firms or enable ATTIS to engage in anticompetitive pricing or other business conduct with which this Commission might be concerned. At least the commenters do not persuasively identify any such possibility.[60]

C. *Investment Tax Credits*

1. *Ratepayer Equity*

32. The transfer of unamortized ITCs to ATTIS together with the associated CPE raises ratepayer equity concerns that are different in some respects, but similar in others, to those raised by the proposed transfer of deferred tax reserves. The differences derive principally from the fact that the ITCs represent permanent tax savings, not merely tax deferrals. Since the tax savings reflected in the unamortized ITC accounts arose under regulation, it can be argued that equitable treatment of ratepayers requires that those accounts remain with the BOCs and be used to reduce rates. As we have already discussed, this was our tentative conclusion in the *Notice*,[61] and a number of commenters supported that conclusion.[62]

33. The similarities between the two ratepayer equity issues derive from the

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reporting purposes. For example, a sale at net book value would result in a zero book gain but a non-zero taxable gain reflecting the lower tax basis of the CPE resulting from accelerated depreciation.

[58] AT&T files a consolidated return, but it has indicated that this tax liability will be allocated to ATTIS. AT&T Response to Bureau Letter at 31.

[59] AT&T argues that only by charging these deferred taxes against a reserve account could ATTIS accurately reflect its operating results. AT&T Response to Bureau Letter at 27–28. It also states that unregulated companies are required by generally accepted accounting principles to account for deferred taxes resulting from different depreciation rates for book and tax purposes in this fashion. *See* AT&T Reply Comments at 44 n.*, citing AICPA Accounting Principles Board, Opinion No. 11. In light of those accounting principles and related financial reporting standards (such as those of the Securities and Exchange Commission), it is quite possible that, if the deferred tax reserves were not transferred, ATTIS would be required to create a reserve on its books to account for these deferred tax liabilities (which could be accomplished by a charge against current income). Indeed, as part of an announced adjustment to its financial statements to take place on December 31, 1983, AT&T will create a deferred tax reserve of $360 million (and reduce 1983 earnings by that amount) to account for certain other tax benefits associated with transferred equipment that have not been normalized in the regulatory process and thus are not currently reflected in deferred tax reserves on the books of the BOCs. *See* AT&T Press Release, Oct. 19, 1983.

[60] Indeed, to the extent these accounts are capable of conferring competitive advantages or disadvantages, the arguments of AT&T and others that failure to transfer the accounts would disadvantage ATTIS in reporting its operating results as compared to its competitors appear more cogent. *See* AT&T Reply Comments at 43–45; *see also* Arthur Andersen Direct Comments at 3–4; SNET Direct Comments at 18–21; GTE Direct Comments at 35–37.

[61] Notice at para. 59.

[62] *See, e.g.*, NATA Direct Comments at 39; California Direct Comments at 14–19; Idaho Direct Comments at 2–3; Michigan Direct Comments at 6; New York Direct Comments at 9–10; Tennessee Direct Comments at 6–8; Washington Direct Comments at 2.

fact that, as was the case with the deferred tax reserves, there are two competing characterizations of the nature and source of the savings associated with ITCs that tend to shape the debate over, and imply different resolutions of, the ratepayer equity question. As with the deferred tax reserves, the opponents of transfer characterize the unamortized ITCs as "overpayments" of taxes by ratepayers that they have a right to recover,[63] while proponents of the transfer characterize the credits as funds provided by the United States Treasury, the benefit of which ratepayers have already enjoyed to the full extent contemplated by the statutes governing the treatment of ITCs by public utilities.[64] And again, as with the deferred tax reserves, Congress appears to have viewed ITCs in a fashion that is compatible with only one of these characterizations. The relevant Code provisions and their legislative history indicate that Congress viewed ITCs as Treasury-supplied subsidies provided to certain taxpayers, including public utilities, to stimulate investment by those taxpayers in productive assets.[65] Further, there is absolutely no indication in either the Code or the legislative history that Congress viewed the restrictions on utilities flowing through ITCs to ratepayers contained in Section 46(f) as a means of extracting tax "overpayments" from ratepayers to provide that investment subsidy. Rather, those restrictions reflect a Congressional view that the ITCs, as funds supplied by the Treasury to stimulate investment, should not be passed on immediately to utility customers, which would only stimulate consumption.[66]

34. Furthermore, the legislative history of the ITC provisions also supports the arguments of some commenters[67] that investment credits are properly regarded as reductions in the costs of acquiring the associated assets.[68] As such, it is argued,

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[63] *See, e.g.*, California Direct Comments at 17; Tennessee Direct Comments at 6.

[64] *See, e.g.*, AT&T Reply Comments at 49–50; Arthur Andersen Direct Comments at 3.

[65] This theme was consistently sounded throughout the committee reports accompanying the Revenue Act of 1962, which first established the credits, *see* H.R. Rep. No. 2508 (Conference Report), 87th Cong., 2d Sess. (1962), Sen. Rep. No. 1881, 87th Cong., 2d Sess. (1962); the Revenue Act of 1964, which prohibited federal regulatory agencies from immediately flowing through the credit to utility customers, *see* H.R. Rep. No. 749, 88th Cong., 1st Sess. 35–37 (1963), Sen. Rep. No. 830, 88th Cong., 2d Sess. 42–43 (1964); and the Revenue Act of 1971, which reestablished the credits (after they had been repealed in the Tax Reform Act of 1969), *see* H.R. Rep. No. 92–533, 92d Cong., 1st Sess. 23–26 (1977), Sen. Rep. No. 92–437, 92d Cong., 1st Sess. 35–39 (1971).

[66] H.R. Rep. No. 92–533, 92d Cong., 1st Sess. 24 (1971); Sen. Rep. No. 92–437, 92d Cong., 1st Sess. 36 (1971).

[67] AT&T Direct Comments at 42 n.*; Arthur Andersen Direct Comments at 2–3; GTE Direct Comments at 37–38.

[68] For example, the Senate Report accompanying the original enactment of the ITC provisions in the Revenue Act of 1962 stated:

> The investment credit will stimulate investment, . . . by reducing the net cost of acquiring depreciable assets, which in turn increases the rate of return after taxes arising from their acquisition. . .. The objective of the credit is to reduce the net cost of acquiring new equipment; this will have the effect of increasing the earnings of new facilities over their productive lives and increasing the profitability of productive investment.

Sen. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962); H.R. Rep. No. 2508 (Conference Report), 87th Cong., 2d Sess. 14 (1962). This characterization of ITCs as reductions in the cost of acquired assets appears again in the legislative histories of the Revenue Act of 1964 and the Revenue Act of 1971. *See, e.g.*, H.R. Rep. No. 749, 88th Cong., 1st Sess. 36 (1963) ("[T]he purpose of the investment credit was to stimulate investment

ratepayers are entitled to share in the benefits of those credits only to the extent they bear the costs of the assets through depreciation charges.[69] Since under Section 46(f)(2) the tax savings from ITCs are amortized (and flowed through to ratepayers) at the same rate that the assets are depreciated, there is no possibility that by transferring the unamortized ITCs ratepayers will be wrongfully deprived of any share of the credits they should have received. (The unamortized ITC, by definition, is that part of the original ITC that is associated with the undepreciated part of the associated asset—that is, that part of the original cost of the asset that has not been paid by ratepayers through depreciation charges.)

35. For example, if a BOC received a 10 percent discount from a supplier on its purchase of a particular item of CPE—so instead of paying, say $1,000 for the CPE, it paid $900—ratepayers would receive the benefit of the cost reduction over the life of the CPE in the form of reduced depreciation charges. If the CPE had a useful life of 10 years, the actual depreciation charges would be $90 rather than $100 per year, and the entire $100 cost reduction originally realized by the BOC would be passed on to ratepayers at the rate of $10 per year. If the CPE were transferred from the BOC to ATTIS before the 10 years were completed, part of the cost reduction would not have been passed on. For example, if the transfer occurred five years after purchase of the CPE only $50 of the $100 total savings would have been realized by ratepayers. Fifty dollars of the original cost savings would in effect be transferred with the CPE (the book value of the asset would be $450 rather than $500). But it seems doubtful that it would be argued that ratepayers were being inequitably treated as a result. In a similar way, it could be argued, the transfer of unamortized ITCs to ATTIS would not be inequitable for ratepayers. And this framework for analyzing the ITC question is generally consistent with the overall statutory scheme for accounting for the benefits of investment credits on public utility property provided in Section 46(f) of the Code.[70]

36. Thus, Congress apparently views ITCs as Treasury-supplied investment subsidies, not ratepayer-supplied funds in the form of tax overpayments, which stimulate investment by reducing the cost of acquiring productive assets. Under these views on the nature and function of ITCs, the transfer of the unamortized credits from

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by reducing the net cost of acquiring depreciable assets."); Sen. Rep. No. 92–347, 92d Cong., 1st Sess. 24 (1971) ("[The] investment credit should be restored as a means of providing stimulus to the lagging domestic economy by reducing the cost of capital to U.S. manufacturers.")

[69] AT&T Direct Comments at 42 n.*.

[70] There is, however, at least one apparent inconsistency between the treatment of ITCs provided in Section 46(f) and the characterization of ITCs as reductions in the cost of assets. A real reduction in the cost of acquiring an asset would be reflected both in lower depreciation charges over the life of the asset and in a reduction in the rate base on which the utility earns a return. (In the example discussed in the text, a BOC acquiring an asset that normally cost $1,000 for a discounted price of $900, would include the $900 in its rate base, but not the $100 "savings.") Under Section 46(f), the ITC savings are either deducted from the rate base (Section 46(f)(1)) or flowed through to income over the life of the asset (Section 46(f)(2)), but not both. As indicated earlier, the Bell System companies have elected the second option. As a result, they include in their rate bases, and earn a return on, the portion of the cost of their assets that has, in effect, been supplied by the United States Treasury through ITCs. Thus, utilities would appear to be better off with a 10 percent ITC than with a 10 percent reduction in the cost of an asset and no ITC. In any event, this "inconsistency" is clearly contemplated, indeed required, by the Code and apparently reflects Congress' view that, while the benefits of ITCs are to be shared with utility ratepayers, a substantial portion of these benefits are to be retained by utility investors so that ITCs will have the desired stimulative effect on investment.

the BOCs to ATTIS together with the associated CPE appears equitable for ratepayers and consistent with Congressional intent in providing ITCs for public utilities.

2. *Normalization Requirements of Internal Revenue Code*

37. AT&T argues that retention by the BOCs of unamortized ITCs associated with the transferred CPE, and use of those credits to reduce revenue requirements of the BOCs, would violate the provisions of the Code governing the treatment of ITCs by public utilities and result in the BOCs losing all ITCs for open tax years.[71] Other parties argue that the BOCs could retain those credits and flow them through to ratepayers in a manner that is consistent with the requirements of the Code and regulations and with no adverse tax consequences for the BOCs.[72]

38. As outlined earlier, under Section 46(f)(2) of the Code, a BOC is eligible to reduce its tax liability through the use of ITCs so long as its cost of service for ratemaking purposes is not reduced by more than a "ratable portion" of those credits. The Code provides that the determination of what is a "ratable portion" of ITCs is to be based on "the period of time used in computing depreciation expense for regulatory purposes." I.R.C. § 46(f)(6). The Treasury regulations elaborate on this requirement:

> What is "ratable" is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. "Regulated depreciation expense" is the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes.

Treas. Reg. 146–6(g)(2). The question then is whether the continued use by a BOC of ITCs to reduce cost of service after the transfer of the associated assets to ATTIS would violate these provisions.

39. The arguments of AT&T and others that such a violation would occur are fairly straightforward. Once the CPE is transferred to AT&T, they argue, there will no longer be any "regulated depreciation expense" with respect to CPE included in the BOCs' cost of service, and hence any further use of ITCs to reduce cost of service would necessarily involve more than a "ratable" reduction in violation of Section 46(f)(2).

40. Of those opposing AT&T on this point, only NATA attempts a rebuttal analysis of the applicable provisions of the Code and regulations.[73] NATA argues that since the period of time used in computing regulatory depreciation expense ends when the assets are transferred from the BOCs, continued amortization of the associated ITCs by the BOCs would involve passing less than a ratable portion of the ITCs to ratepayers, which would not be inconsistent with the tax law.[74]

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[71] AT&T Direct Comments at 42–44; AT&T Reply Comments at 48–49. AT&T's position on this point is supported by a number of other commenters. *See, e.g,* Arthur Andersen Direct Comments at 3; Centel Direct Comments at 9; GTE Direct Comments at 38; SNET Direct Comments at 20–21.

[72] *See, e.g.*, NATA Reply Comments at 41–44; California Direct Comments at 18–19.

[73] California argues that the Code provides for a sharing of the benefits of ITCs between utilities and their ratepayers and that continued amortization of the ITCs would permit that sharing arrangement to continue. But this argument appears to beg the critical questions, which are what are the terms of that sharing arrangement and, in particular, does the Code provide for that sharing to continue after the associated assets have been transferred. California goes on to assert that immediate flow-through of ITCs, as proposed in the Notice, would violate the tax laws but that amortization over a 10-year period, or such other periods as may be ordered by state commissions, would not. California Direct Comments at 18–19.

[74] NATA Reply Comments at 41–44.

41. The express terms of the Code and the regulations do not conclusively resolve this issue. AT&T argues that by tying the determination of "ratable portion" to the regulatory depreciation period of the associated assets, Section 46(f) and the accompanying regulations prohibit the flow-through of ITCs when ratepayers are not also bearing the depreciation expenses of those assets. But those provisions do not say that in so many words; their focus is more on the computational issues of determining a "ratable portion" of an ITC, and they simply assume that the associated property is held, and is being depreciated, by the utility.

42. Nevertheless, the concept of "ratable portion" as set forth in the Code and the regulations is so closely connected with the depreciation process that it seems unlikely that continued flow-through of ITCs to ratepayers after the regulatory depreciation of the associated assets has stopped would be deemed consistent with those requirements. Conversely, the position that ratepayers are entitled to receive that portion of the ITCs exactly equal to the portion of the cost of the associated assets they have borne through depreciation charges, and no more, seems generally consistent with those provisions.

43. This position draws some further support from a revenue ruling in which the IRS, in holding that a regulatory commission could properly exclude non-utility operations of a public utility in determining the ratable portion of ITC to be flowed through to ratepayers, emphasized the interrelationship between ITCs and other ratemaking elements:

> Section 46(f) of the Code recognizes that in a ratemaking context there is a fundamental relationship between use of the ITC, the rate base, and the cost of service. In its exclusion of nonpublic utility operations in this case, the regulatory commission has not isolated the ITC from other ratemaking factors but has kept constant the ITC's fundamental relationship with other cost of service factors.[75]

It would appear that a ratemaking scheme that continued the flow-through of ITCs to ratepayers after the BOCs (1) had reduced their rate bases to reflect the transfer of the associated CPE, and (2) no longer included any costs associated with the CPE in their cost of service, would "isolate" the ITC from ratemaking factors and sever the "fundamental relationship" between the ITCs and those factors, contrary to the position taken in the ruling.

44. Accordingly, in our view it is likely that retention by the BOCs of the ITCs and the continued flow-through of those credits to ratepayers would violate the normalization requirements of the Code. Thus, the proposed treatment of the ITCs set forth in the *Notice* as well as the gradual flow-through proposed by certain commenters, would place in jeopardy the BOCs' eligibility for both past (in open tax years) and future ITCs.[76]

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[75] Rev. Rul. 81–17. The issue addressed by the ruling arose because the taxpayer's non-utility subsidiaries were experiencing losses, which had the effect of reducing the amount of ITCs the parent could claim on its consolidated return below the amount attributable to its utility operations. The regulatory commission required the utility to reduce its cost of service by a ratable portion of the latter amount rather than by a ratable portion of the smaller amount allowed on the consolidated return.

[76] The IRS did move against Pacific Telephone and Telegraph Company (PT&T) in this fashion as a result of a California Public Utility Commission (CPUC) order concerning the ratemaking treatment of accelerated depreciation and ITCs. CPUC Decision No. 87838 (1977). The CPUC had ordered an average annual adjustment (AAA) approach to accelerated depreciation, which required projected increases in the deferred tax reserve to be deducted from the rate base, but did not recognize the corresponding net increases in the rate base from increased investment (and associated changes in depreciation reserves) that gave rise to the

3. Possible Competitive Advantages for ATTIS

45. Some commenters argue that transfer of unamortized ITCs would confer unfair advantages on ATTIS vis-a-vis its CPE competitors.[77] The considerations affecting this issue are similar to those discussed earlier concerning possible advantages conferred on ATTIS by the transfer of deferred tax reserves. Here, as there, it does not appear that the opponents of transfer have made a convincing case.

46. If the unamortized ITCs are transferred to ATTIS, it could continue to amortize them over the remaining life of the associated CPE, although as an unregulated firm it could conceivably flow through the credits to income at a faster rate.[78] This use of the ITCs would not result in ATTIS receiving any extra cash, but would allow it to reduce its book tax expense (but not its actual tax liability). AT&T argues that its competitors will be able to account for their ITCs in exactly this way on their books, and it should be able to do so in the same fashion.[79] Furthermore, ATTIS would appear to be responsible for any recapture of ITC that occurs as the result of sales of CPE prior to the requisite holding period provided in Section 47(a) of the Code.[80] Again, the unamortized ITCs would not provide any cash to pay for this tax liability, but would provide an account, other than income, against which such payments could be charged.[81] In our view, these appear to be proper uses of the unamortized ITC accounts. And, as with the deferred tax reserves, we are not persuaded by the opponents of transfer that these reporting and accounting factors would provide the means for ATTIS to engage in anticompetitive conduct or otherwise adversely affect competitive conditions in the CPE marketplace.

D. *Conclusion*

47. Deferred tax reserves and unamortized ITC accounts are fundamentally related to the assets that give rise to them, and ordinarily they should not be

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increases in the tax reserves. *Id.* The CPUC had ordered a similar annual adjustment (AA) method for projected increases in the unamortized ITC account. The IRS found that the AAA approach constituted a non-normalized method of accounting in violation of Section 167(1) of the Code and that the AA approach resulted in more than a ratable flow-through of ITCs in violation of Section 46(f)(2) of the Code. *See* IRS Letter Rulings to PT&T of June 8, 1978, and July 27, 1978. PT&T lost its eligibility for accelerated depreciation and ITCs and incurred a substantial tax liability as a result of the disallowance of depreciation deductions and investment credits previously taken. Congress provided partial relief for this liability (the disallowance was limited to the tax benefits actually flowed through to consumers too rapidly) and amended Sections 167(1) and 46(f) of the Code to make clear that the approaches ordered by the CPUC did not comply with the normalization requirements of those sections. Surface Transportation Assistance Act of 1983, Pub.L. No. 97–424, § 541 (Jan. 6, 1983).

[77] *See* NATA Direct Comments at 39; California Direct Comments at 17–18; CBEMA Direct Comments at 5–6.

[78] Generally accepted accounting principles, while requiring normalized treatment of accelerated depreciation, only recommend such treatment of ITCs. *Compare* AICPA Accounting Principles Board, Opinion No. 11 (accelerated depreciation), *with* AICPA Accounting Principles Board, Opinions No. 2 and No. 4 (investment tax credits).

[79] AT&T Direct Comments at 45 n. **; AT&T Response to Bureau Letter at 33.

[80] For most CPE, the required holding period to avoid any recapture is seven years for property placed in service prior to 1981 and five years for property placed in service after 1980. I.R.C. § 47(a).

[81] Thus, the income and operational results AT&T will be able to show on its financial reports will be better if the unamortized ITCs are transferred than if they are not.

separated from those assets. The major objections raised in this proceeding to transferring those accounts (with their related assets) from the BOCs to ATTIS—that such transfers would be inequitable to ratepayers of the BOCs and would disadvantage competitors of ATTIS—do not appear to be substantial. Conversely, leaving the reserves or the unamortized credits with the BOCs does appear to raise a serious risk of violation of the Internal Revenue Code with resulting adverse tax consequences for the BOCs. Accordingly, we conclude that the most appropriate course for us to take with respect to these accounts is to provide for their transfer to ATTIS together with the associated embedded CPE.

III. ANCILLARY ISSUES

48. There are a number of ancillary issues concerning taxes raised either in the *Notice* or in the comments, which are briefly summarized and considered below.

A. *Should only the "present value" of the deferred tax reserves be transferred to AT&T or, alternatively, should AT&T be required to pay interest periodically to the BOCs on the balance of the deferred tax reserves?*

49. These alternatives were suggested by a number of commenters.[82] The legal and equitable considerations applicable to a complete retention of the deferred tax reserves by the BOCs, outlined above, apply as well to a partial retention of reserves.[83] And payment of interest on the reserves, while in one sense equivalent to a present value adjustment, would (because it involves the transfer of cash between the then-divested BOCs and AT&T) raise even more complex legal and equitable concerns.[84] Accordingly, we decline to adopt either of these alternatives.

B. *Should any adjustment be made to the deferred tax reserves to account for the possibility that gain on the sale of the CPE might be taxed at capital gain, rather than ordinary income, rates?*

50. We raised this question in the *Notice* because we were concerned that the deferred taxes associated with the CPE, which accumulated at ordinary income rates, might be repaid by ATTIS at capital gain rates. AT&T and other commenters who analyzed this issue pointed out that under the relevant sections of the Code any gain on the sale of the CPE up to the amount of the tax depreciation previously claimed would be taxable at ordinary income rates.[85] (And the tax on any gain in excess of that amount has not been deferred, is not reflected in the deferred tax reserves, and would not be charged to that account.) The position of these commenters appears to us to be correct. We conclude that no such "capital gain" adjustment to the deferred tax reserves is necessary.

C. *Should there be any adjustment to the deferred tax reserves to reflect the fact that those reserves accumulated, in part, at tax rates higher than those currently in effect?*

51. Some commenters note that the corporate tax rate through most of the 1970's was somewhat higher than the current rate (48 percent v. 46 percent).[86] As a result, they argue that the deferred tax reserves transferred to ATTIS should be

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[82] *See, e.g.*, NATA Direct Comments at 35–39; NATA Reply Comments at 48–50; CBEMA Reply Comments at 8; California Direct Comments at 12–14; ICA Direct Comments at 9–11.

[83] *See* paras. 23–31, *supra*.

[84] For example, AT&T argues that any such cash payments would jeopardize the tax-free status of the CPE transfer. AT&T Response to Bureau Letter at 29.

[85] I.R.C. § 1245. *See, e.g.*, AT&T Direct Comments at 38–39; SNET Direct Comments at 21; GTE Direct Comments at 35–36; California Direct Comments at 12.

[86] *See* New York Comments at 7. The deferred tax reserves have accumulated at the following rates:

reduced to take this rate differential into account, lest those reserves exceed ATTIS's actual deferred tax liability associated with the transferred CPE. While this raises a fair point, there are countervailing considerations that suggest that such an adjustment should not be made. First, this is not a standard adjustment for deferred tax reserves in either the regulated or unregulated sector; our rules do not provide for adjustments to deferred tax reserves to account for changing tax rates, and generally accepted accounting principles prohibit such adjustments.[87] Second, tax rates could go up in the future, in which case such an adjustment would have been inappropriate. Third, the adjustment would involve a divergence from the transfer of accounts at book value, which, as AT&T notes, is a guiding principle of this proceeding as well as of the MFJ.[88] Fourth, the transaction is less problematic from a tax viewpoint if the entire reserve is transferred.[89] Fifth, the amount of money involved is relatively small (on the order of $42–47 million or approximately 2 percent of the total reserves associated with the embedded CPE).[90] Weighing these various factors, we conclude that, on balance, it would not be appropriate to provide for such an adjustment to the deferred tax reserves associated with the embedded CPE to be transferred from the BOCs to ATTIS.

D. *Should the Commission defer its decision on the transfer of the deferred tax reserves and unamortized ITC accounts pending issuance of IRS rulings?*

52. AT&T has submitted requests for rulings to the IRS on a number of aspects of the Bell System reorganization. Among these are requests for rulings on whether the BOCs could retain the deferred tax reserves and unamortized ITCs associated with the embedded CPE and use those reserves or credits to reduce their rate bases or costs of service after the transfer of those assets.[91] A number of commenters have suggested that we await IRS action on these requests before resolving the tax issues in this proceeding.[92] We agree it would be useful to have those rulings available at this time. However, the IRS has not yet acted on AT&T's requests, and we do not think it appropriate, in light of the time constraints under which the parties involved in the embedded CPE transfer are operating, to defer our own decision in this proceeding pending such IRS action. For the reasons discussed above, we are content that, quite apart from the technical requirements of the Code, the transfer of the deferred tax and unamortized ITC accounts with the associated assets is proper in the circumstances of this case. Thus, even if the IRS were to rule that under the tax laws those

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1970	49.2 percent
1971–78	48.0 percent
1979-Present	46.0 percent

AT&T Response to Bureau Letter at 26 n.*. AT&T did not utilize accelerated depreciation prior to 1970, so no part of the reserves is attributable to that period.

[87] AICPA Accounting Principles Board, Opinion No. 11.

[88] AT&T suggests a number of other adjustments to the book value of accounts, including the deferred tax reserves, that it argues would be appropriate if adjustments to book value are to be made. *See* AT&T Reply Comments at 43 n.*.

[89] Leaving part of the reserves with the BOCs could raise some of the concerns about consistency with the requirements of the Code discussed above. *See* paras. 28–29, *supra*.

[90] AT&T Response to Bureau Letter at 26.

[91] AT&T indicated in its October 7, 1983, response to our request for information that it has sought such a ruling with respect to ITCs, AT&T Response to Bureau Letter at 25, and subsequently informed us that it has sought a similar ruling with respect to deferred tax reserves.

[92] *See, e.g.*, GTE Direct Comments at 38; CBEMA Reply Comments at 8 n.4; NATA Comments on AT&T Response to Bureau Letter at 19–20; ICA Comments on AT&T Response to Bureau Letter at 7.

accounts could be retained by the BOCs, we consider it unlikely that we would reach different conclusions from those we reach today.[93] Nevertheless, should the IRS issue such rulings, we would be prepared to consider the possibility of reexamining our conclusions on these matters at an appropriate time.

APPENDIX B

Summary of Requirements Established in Report and Order

I. INTRODUCTION

1. This Appendix summarizes requirements established by the Commission in the accompanying *Report and Order*. This Appendix is intended as a reference guide for those interested in reviewing the requirements established in the *Order*, and shall not be construed as having any substantive or operative effect. Further, its focus is on particularized requirements which call for specific conduct and compliance by AT&T or ATTIS, or both. More general findings and conclusions (*e.g.*, the Commission's findings in Part IV of the *Order* regarding the scope of its authority) are not included.

II. VALUATION

2. Net book value (defined as original cost of an asset less the related depreciation reserve) will be used to determine the value of the embedded CPE base transferred from the BOCs to ATTIS and for purposes of establishing sale prices for the embedded CPE. *Order* at Part V.B.1. For purposes of valuing the embedded base for transfer, and establishing sale prices, the embedded base must be disaggregated into single-line equipment and multi-line equipment. *Order* at Part V.B.2.

III. RESIDENCE AND BUSINESS SINGLE-LINE CPE

A. *Sale Plan*

3. Residence and business single-line CPE must be offered for sale to in-place customers during a transition period of at least two years at the prices announced by AT&T in its Further Supplementary Comments. *Order* at para. 11 n.15. AT&T shall notify in-place customers regarding their options prior to detariffing. ATTIS shall arrange for materials to be included in BOC bill inserts which request customers to choose between buying and leasing their CPE (with the same steps being specified to make either choice). If the customer does not respond, ATTIS shall construe this as an intention to continue leasing. *Order* at para. 67.

4. AT&T must submit monthly reports to the Commission during the two-year transition period regarding the single-line CPE sale plan. These reports shall specify (1) the amount of embedded single-line CPE sold by ATTIS; (2) total revenues from these sales; and (3) the relationship between this revenue and the value at which the embedded single-line base was transferred to ATTIS. *Order* at para. 70. AT&T is permitted to calculate transaction costs regarding single-line CPE sales in the manner it proposed in Appendix D of its Direct Comments. *Order* at para. 74.

B. *Monthly Lease Plan*

5. Residence CPE must be offered for lease to in-place customers during a transition period of at least two years at the prices specified by AT&T in its Further Supplementary Comments. *Order* at para. 11 n.15. If a standard rotary customer

[93] There appears to be no question that the transfer of those accounts to ATTIS with the associated assets does *not* conflict with the tax laws. The only issue seems to be whether the Code permits retention, as well as transfer, of these accounts by the BOCs.

currently is paying less than $1.00 per month under state tariff, ATTIS's initial rate for that customer shall not impose an increase of more than $.50, and the monthly rate for that customer shall not be increased to $1.50 until January 1, 1985. For other residence CPE customers, the maximum initial increase will be $1.00 over the current lease rate. These rates for other residence CPE customers shall not be subject to any increases until October 1, 1984. *Order* at para. 75. During the transition period, ATTIS will repair or replace embedded consumer CPE brought to central facilities, and will mail replacement CPE to customers at no charge. *Id.*

6. If ATTIS chooses to delay initial lease rate increases or decreases for single-line (or multi-line) CPE until March 1, 1984, ATTIS must notify the Commission of its intention to do so not later than 30 days after the release date of the *Order*. *Order* at para. 75 n.68. If existing lease rates for any residence CPE are higher than ATTIS's national lease rates, ATTIS shall reduce these customers' rates to the national level. *Order* at para. 75. In applying the $.50 and $1.00 increase ceiling, ATTIS shall refer to current state tariff rates actually in effect. *Order* at para. 75 n.69.

C. *Adjustment of Lease Rates*

7. ATTIS is permitted to increase lease rates for residence CPE (other than standard rotary) during the transition period based upon increases in the Consumer Price Index (CPI). If ATTIS desires to impose increases at rates greater than the rate of increase in the CPI, as a result of extraordinary cost increases, it must obtain prior approval from the Commission. *Order* at para. 78 n.70; para. 79.

D. *Other Issues*

1. *Warranties*

8. ATTIS shall provide a 90-day warranty for residence and business single-line CPE purchased in place. The terms and conditions of these warranties shall be those indicated by AT&T in its Further Supplementary Comments. Telephone housings and cords may be excluded from this warranty coverage. *Order* at para. 82 & n.74.

2. *Interest Charges*

9. ATTIS is permitted to charge interest, subject to state usury laws, in connection with installment purchases of the embedded single-line base. *Order* at para. 83.

3. *Party-Line Equipment*

10. ATTIS shall offer party-line CPE for sale in all jurisdictions, subject to conditions regarding repairs to ensure that malfunctioning party-line CPE does not impair service to other parties. *Order* at para. 84.

IV. MULTI-LINE CPE

A. *Duration of Sale and Lease Periods*

11. The transition period for each product line of multi-line CPE shall commence at the time ATTIS notifies the customer involved in writing that it has initiated a sale program for that product line. *Order* at para. 91. This written notice also must be filed with the Commission. ATTIS also must furnish multi-line customers with general information regarding its sale and lease programs, including a statement that the customer may purchase from other vendors. *Order* at para. 91 n.86. The transition period for multi-line CPE shall be two years. *Order* at para. 93.

B. *Sale Plan*

12. ATTIS is permitted to use the criteria specified in AT&T's Supplementary Comments for purposes of determining the timing of initial sale offerings for multi-

line CPE product lines. *Order* at para. 97 & n.93. ATTIS must offer for sale all multi-line CPE. *Order* at para. 99. With regard to non-standard multi-line equipment, ATTIS shall provide price quotations upon request and shall guarantee these price quotations for 90 days. *Order* at para. 98. ATTIS shall furnish written notice of this purchase option to users of non-standard CPE; the two-year price predictability period shall begin on the date of transmittal of this written notice.

13. Regarding embedded CPE not offered for sale at the time of divestiture, ATTIS must transmit written notice to the Commission not later than 10 days after such CPE is initially offered for sale during the transition period. ATTIS must file monthly reports to the Commission during the transition period which shall specify (1) the amount of embedded multi-line CPE sold by ATTIS; (2) total revenues from these sales; and (3) the relationship between this revenue and the value at which the embedded multi-line CPE was transferred to ATTIS. *Order* at para. 99.

14. The notice to the Commission which ATTIS is required to file regarding the offering for sale of multi-line CPE product lines shall include a detailed statement of transaction costs included in the sale prices, and the methodology for deriving these transaction costs. With regard to multi-line CPE which will be offered for sale at the time of divestiture, AT&T shall submit a report to the Commission containing such information regarding transaction costs not later than 30 days after divestiture. *Order* at para. 102.

C. *Monthly Lease Plan*

15. Customers currently paying more than the national lease rates announced by ATTIS will immediately be moved down to the national lease rate. If a customer is paying less than the initial minimum lease rate established by ATTIS for the product line involved, that customer will be moved up to the initial minimum if that product line is offered for sale by ATTIS at the time of detariffing. If a customer is paying more than the initial minimum but less than the national average, and the product line involved is offered for sale at divestiture, that customer will initially remain at the current lease rate and then will be moved up to the national lease rate in three or fewer stages, depending on the level of the customer's current lease rate.

16. If a customer is paying less than the national initial minimum lease rate, and the product line involved is not offered for sale by ATTIS at divestiture, that customer will remain at the current lease rate until the product line is offered for sale. At the time of the initial sale offering, the customer will be moved up to the initial minimum lease rate and then will be moved up to the national rate in three stages of equal rate increases occurring eight months apart.

17. If a customer currently is paying more than the initial minimum but less than the national lease rate, and the product line involved is not offered for sale at divestiture, that customer will remain at the current rate until the product line is offered for sale. After the initial sale offering, the customer will be moved up to the national rate in three or fewer stages occurring eight months apart during the transition.

18. The lease rates which ATTIS may establish during the transition period for any product line of multi-line equipment which is not also leased as new equipment by ATTIS shall not exceed the higher of (1) an amount equal to 70 percent of the highest state tariff in effect for the category of equipment involved on March 29, 1983; and (2) the statistical median of all state tariffs in effect on that date for that category of equipment. ATTIS's lease rate proposal for embedded CPE also leased as new equipment by ATTIS is accepted. *Order* at Part VII.D. Special assembly CPE customers will continue to pay their current lease rates during the two-year transition period. *Order* at para. 106 n. 100.

D. *Other Issues*

19. ATTIS must provide a 90-day limited warranty for multi-line CPE purchased during the transition period. Financing arrangements in connection with such purchases shall be the same as for new CPE sold by ATTIS, except that ATTIS may vary terms and conditions to reflect the fact that the embedded multi-line CPE is used equipment. *Order* at Part VII.E.

V. SUPPORT OF EMBEDDED CPE DURING TRANSITION PERIOD

A. *BOC Billing and Related Support Services*

20. The BOCs are authorized to provide billing and related support services to ATTIS during the period beginning January 1, 1984, and ending June 30, 1985. *Order* at Part VIII.A.1. The methodology for computing compensation for these services may be the same as that required by the District Court's approval of the AT&T Plan of Reorganization. *Order* at Part VIII.A.2.

21. AT&T may not make competitive use of customer proprietary information. To the extent possible, the BOCs must mask this information or otherwise render the information inaccessible to ATTIS. Where this is not possible, access to this information within ATTIS must be limited to business office personnel who have a need-to-know. Marketing personnel within ATTIS shall not have any access to this information. *Order* at para. 120. AT&T shall control dissemination within ATTIS of basic service information through employee instruction and disciplinary action (including dismissal). *Order* at para. 123.

22. ATTIS must furnish all in-place customers with written notice that ATTIS will provide these customers with information relating to their CPE. The notice given to single-line customers shall specify that the customer may terminate lease service and obtain equipment for other vendors. This notice must be provided at the beginning of the transition period. In the case of multi-line customers whose CPE is not offered for sale at the time of divestiture, ATTIS must provide them with a second notice at the time their equipment is initially offered for sale.

23. ATTIS shall include, in the monthly report to the Commission required in the *Order* at para. 99, a description of the steps taken to comply with these customer information requirements. The report shall include a model customer notification and specific information regarding the manner in which notification has been carried out. *Order* at paras. 125–126 & nn. 107–08. ATTIS must respond to customer requests for CPE information by providing all pertinent information which ordinarily would be used by a CPE vendor in connection with providing equipment to the customer. *Order* at para. 128.

24. ATTIS shall not be required to compensate BOCs for the value of the transferred customer information. *Order* at Part VIII.A.4. The CPE portion of customer bills shall include a legend which indicates that the CPE portion of the bill is provided as a service to ATTIS, that there is no connection between the BOC involved and ATTIS, that the customer may choose another CPE vendor while still receiving local telephone service from the BOC, and that the BOC may not terminate local telephone service for nonpayment of ATTIS CPE charges. *Order* at Part VIII.A.5. Any partial payment by a customer to a BOC shall be applied first against charges for transmission services provided by the BOC. *Order* at Part VIII.A.6.

B. *Maintenance and Related Support of Embedded CPE by ATTIS*

25. In general, ATTIS shall provide maintenance and support in the manner proposed by AT&T in its pleadings in this proceeding. *Order* at paras. 138–139. ATTIS may not phase out maintenance and support of any CPE product line on less than one year's written notice, unless circumstances beyond ATTIS's control require notice of

less than one year. In such a circumstance, ATTIS must report to the Common Carrier Bureau, no later than the date of the announcement of the phase-out, regarding its plans for discontinuance of maintenance and support. The notice of maintenance phase-out must be made to all customers using the embedded CPE involved.

26. ATTIS must make available, no later than the date of the announcement of its intent to phase out maintenance support, all technical information and rights necessary for the support of the equipment. ATTIS may charge reasonable, compensatory rates for such information and rights. During the transition period, ATTIS shall not prevent equipment-to-equipment interconnection between its embedded CPE and other vendors' components and adjunct devices registered under Part 68 of the Commission's Rules and Regulations. *Order* at Part VIII.B.

VI. TAX ISSUES

27. Deferred tax reserve accounts and investment tax credit accounts shall be transferred to ATTIS together with associated CPE assets. Deferred taxes on Western Electric profits shall be restored in the manner proposed by AT&T in this proceeding. The transferred CPE assets will be carried on ATTIS's books at net book value, and the deferred tax reserve and unamortized investment tax credit accounts will be maintained as separate accounts on ATTIS's books. If ATTIS plans a different treatment, it must notify the Commission of this plan before it is implemented. *Order* at Part VIII & Appendix A.

VII. ACCOUNTING ISSUES

A. *Supporting Assets*

28. Land and buildings must be transferred to ATTIS at appraised value. All other supporting assets, however, must be transferred at net book value. Gains in the value of transferred land shall be recorded in account 360, "Extraordinary income credits," but such gains should be allocated to ratepayers in future federal and state ratemaking proceedings.

29. Appraisal costs for land and buildings must be borne by the BOCs. Although account 139, "Other deferred charges," may be used on an interim basis to reflect the original cost of supporting assets to be transferred, no balance should remain in account 139 on the BOCs' books after the transfer of supporting assets to ATTIS. If the appraised value of land and buildings transferred to ATTIS is reduced by the appraisal costs, then appraisal costs may not be charged in the BOCs' account 675, "Other expenses." *Order* at Part IX.A.

B. *Accounting for Proceeds of CPE Sold Under Regulation*

30. Current accounting rules shall apply to CPE sold under state regulation by the BOCs prior to divestiture. Under these rules, proceeds realized from sale are treated as gross salvage and credited to the depreciation reserve. *Order* at Part IX.B.

VIII. OTHER RELATED ISSUES

A. *Intrasystem Wiring*

31. Intrasystem wiring currently owned by the BOCs shall remain with the BOCs and shall not be transferred to ATTIS with associated embedded CPE. *Order* at Part XI.A.1. CPE station handling costs shall remain on the books of the BOCs and shall not be used as a basis for adjusting the net book value of CPE transferred to ATTIS. *Order* at Part XI.A.2.

B. *CPE Associated with NSEP Communications Systems*

32. Certain CPE associated with national security and emergency preparedness

communications systems shall be detariffed and transferred to ATTIS subject to the same requirements and procedures established for other CPE in AT&T's embedded base. This detariffing and transfer requirement shall not take effect until June 1, 1984, thus affording interested parties sufficient time to petition the Commission for a waiver of this requirement. *Order* at Part XI.B.

IX. EMBEDDED BASE CAPITALIZATION

A. *Capitalization*

33. AT&T's treatment of debt which it intends ATTIS to assume is approved. *Order* at Part XII.B.1. AT&T must notify the Commission, no later than 30 days after release of this *Order*, if any provision of AT&T's announced year-end write-down of assets and other bookkeeping adjustments is inconsistent with the record of this docket. *Order* at para. 178 n.154. ATTIS shall assume liability for payroll and benefits expenses of BOC employees who are transferring to ATTIS, and the BOCs may make cash payments to ATTIS during 1984 in the amount of this liability. *Order* at Part XII.B.2.

34. If expensed assets are transferred to ATTIS, ATTIS shall reimburse the BOCs for 50 percent of the original cost of these assets acquired in 1983. ATTIS also shall reimburse the BOCs for 50 percent of the unallocated balance of 1983 exempt materials expenses, after amounts already allocated to ATTIS in 1983 are subtracted from the expenses. ATTIS shall submit a report to the Common Carrier Bureau regarding expensed assets not later than 30 days after the release of this *Order*. *Order* at Part XII.B.3. The Common Carrier Bureau staff shall include in its ongoing audit of *Second Computer Inquiry* implementation a reconciliation of regulated accounts with capital asset transfers to ATTIS. *Order* at Part XII.B.4.

B. *Effect on Basic Service Quality and Rates*

35. AT&T's funding authorization for the capitalization of ATTIS shall be reduced by $250 million to reflect the transfer of the Consumer Products Division from ATTIS to Western Electric. Otherwise, AT&T's aggregate funding of ATTIS is not disturbed. *Order* at Part XII.C.

C. *Pre-Approval Expenses Associated with Proposed Asset Transfer*

36. The costs of identifying and inventorying CPE assets to be transferred from the BOCs to ATTIS shall be borne by the BOCs. The Common Carrier Bureau staff shall ensure, as part of its ongoing audit of *Second Computer Inquiry* implementation. that BOC-borne costs associated with the transfer and conversion of CPE customer records do not include any costs of reformatting records for use by ATTIS. ATTIS shall reimburse the BOCs for 50 percent of CPE refurbishing costs incurred in 1983 by the BOCs. *Order* at Part XII.D.1.

37. ATTIS shall be attributed with contingent tax liabilities arising from pre-transfer events. These liabilities shall be allocated on the same basis as that by which the AT&T Plan of Reorganization assigns contingent tax liabilities between AT&T and the BOCs. Responsibility for fulfilling warranties applicable to CPE sold under regulation by the BOCs shall be assigned to ATTIS. The *Order* shall not be construed as preventing customers from obtaining warranty service from the entity which sold the CPE under regulation. In such cases, the cost of such warranty service may be billed to ATTIS by the BOC involved. *Order* at Part XII.D.2.

Common Carrier, Service, Duty to Furnish
Common Carrier, Specialized Services
Telecommunications Services For Deaf

Motion for Expedited Consideration of detariffing issue related to implementation of Telecommunications for the Disabled Act of 1982, Pub. L. 97–410, granted in part and denied in part. To best further the purposes of the Act, The Commission forgoes detariffing specialized customer premises equipment.
–*Telecomm. For Disabled Persons*
CC Docket No. 83–427

FCC 83–517

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of Access to Telecommunications Equipment by the Hearing Impaired and other Disabled Persons	CC Docket No. 83–427

MEMORANDUM OPINION AND ORDER

(Adopted November 8, 1983; Released November 25, 1983)

BY THE COMMISSION:

I. *INTRODUCTION*

1. On January 3, 1983, the President signed into law the Telecommunications for the Disabled Act of 1982, Pub. L. 97–410 (to be codified as 47 U.S.C. § 610). In subsection (g) of the Act, Congress created an exception to the Commission's *Computer II* decisions[1] by permitting carriers to provide "specialized terminal equipment" or customer premises equipment ("specialized CPE") under tariff or otherwise to disabled persons in need of such equipment and permitting states to conduct programs whereby specialized CPE would be subsidized through revenues received from rates for tariffed communications services. The Act also requires the Commission to adopt regulations to ensure hearing impaired persons

[1] Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384 (Final Decision), *reconsideration*, 84 FCC 2d 50 (1980), *further reconsideration*, 88 FCC 2d 512 (1981), *aff'd sub nom.* Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert denied*, 103 S. Ct. 2109 (1983).

"reasonable access" to telephone service and to provide that certain "essential telephones" be usable with hearing aids.

2. On May 4, 1983, we released a Notice of Proposed Rulemaking (NPRM), 48 Fed. Reg. 20771, designed to implement the Act. Congress has required that we adopt final rules by January 3, 1984, and we will do so. Nevertheless, one issue regarding the implementation of the Act requires resolution now in order to avoid confusion concerning the availability of CPE to the disabled immediately after the planned divestiture of the Bell System Operating Companies (BOCs) from the American Telephone and Telegraph Company (AT&T) on January 1, 1984 pursuant to the Modification of Final Judgment (*MFJ*) issued in *United States v. American Telephone and Telegraph Co.*[2] That issue is whether in light of Congress' action we should require the detariffing of specialized terminal equipment or instead leave the decision to the states. AT&T requests approval by us of a plan to detariff both embedded[3] and new specialized CPE. In place of providing this equipment under tariff, AT&T proposes a three-year price predictability and sales plan similar in form to the plan it has proposed for the detariffing of embedded CPE generally. See AT&T's Supplementary Comments filed in CC Docket No. 81–893 (September 15, 1983).

3. Organizations representing the disabled[4] have joined together to file a motion requesting expeditious resolution of the detariffing issue AT&T has raised and of other questions related to the implementation of the Act. These organizations believe it would be inconsistent with the Act for this Commission to order the detariffing of specialized CPE. They request that we reach this conclusion quickly, so that they may file a motion with the Court in the *MFJ* proceedings, requesting that embedded specialized CPE remain with the BOCs, rather than be transferred to AT&T as is currently planned. In response to this motion we are separating out the detariffing issue for treatment in advance of other implementation

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[2] 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 103 S. Ct. 1240 (1983). AT&T's application with this Commission for authority to transfer ownership of facilities is currently under review. *See* File No. W-P-C-4955.

[3] Embedded CPE is CPE which was subject to the jurisdictional separations process as of January 1, 1983. See Further Reconsideration, 88 FCC 2d at 526. The Commission is considering the method for detariffing such equipment in the Implementation Proceeding, CC Docket No. 81–893, FCC 83–181 (released June 21, 1983). That proceeding will not treat specialized CPE which is subject to the provisions of the Telecommunications for the Disabled Act. *Id.* at para. 2 n.4.

[4] These organizations include: National Center for Law and the Deaf; National Association of the Deaf; Paralyzed Veterans of America; Alexander Graham Bell Association for the Deaf; American-Speech-Language-Hearing Association; American Council of the Blind; Self-Help for the Hearing-Handicapped; American Deafness and Rehabilitation Association; Disability Rights Center, Inc.; National Rehabilitation Association; Conference of Educational Administrators Serving the Deaf, Inc.; Convention of American Instructors of the Deaf.

issues, which require more time, but in any event will be resolved before January 3, 1984. We find today that it would best further the purposes of the Act for this Commission to forego detariffing specialized CPE.

II. *PLEADINGS OF THE PARTIES*

4. AT&T argues that Congress has not precluded our detariffing of specialized CPE for the disabled. In support AT&T states that the NPRM indicated that the decision to tariff specialized CPE is initially for carriers to make; that the Act does not bar AT&T's plan; that Congress intended the free market to ensure a supply of specialized CPE, which detariffing would effectuate; and that states will be able to regulate specialized CPE if the price predictability plan does not produce satisfactory results. AT&T further argues that, whether or not the equipment is tariffed, states can maintain programs to subsidize specialized CPE by collecting surcharges from customers of local exchange carriers and equipment vendors.

5. The National Association of Regulatory Utility Commissioners (NARUC), the National Association of the Deaf and the National Center for Law and the Deaf (Joint Commenters), the Organization for Use of the Telephone (OUT) and Walker Equipment Corporation (Walker) filed comments in opposition to AT&T. NARUC, the Joint Commenters and OUT assert that our approval of AT&T's request would violate the Act and contravene Congress' intention to vest with the states the power to tariff or detariff specialized CPE. GTE filed a reply asserting that the Act does not require specialized CPE to be tariffed, pointing out that not all of its current offerings of specialized CPE are tariffed.

III. *DISCUSSION*

6. In our *Computer II* decisions, we ordered that all carrier-provided CPE be detariffed and unbundled from the provision of regulated transmission service.[5] Pursuant to *Computer II*, AT&T and its affiliates may provide CPE only through a separated subsidiary, and other common carriers providing CPE are required to keep books of account and records for the provision of new CPE separate from regulated records.[6] In the Computer II decision on reconsideration, we stated that the "bundling of non-usage sensitive CPE into usage-sensitive rates for service is very likely to result in misallocation of costs among services and facilities offerings."[7] Therefore, we concluded that certain ratepayers, through payments for transmission services, were potentially cross-subsidizing CPE used by other

[5] 77 FCC 2d at 496 (para. 288).

[6] *Id.* at 497 (para. 290).

[7] 84 FCC 2d at 99 (para. 140); *see* 77 FCC 2d at 444–45 (para. 154).

ratepayers, and that such a situation was inconsistent with our policies fostering competition in the communications marketplace. This situation could only be remedied by unbundling and detariffing CPE.[8] Accordingly, we expressly precluded state regulatory agencies from requiring the tariffing of "new CPE" after December 31, 1982, and left to another proceeding the question of when and under what conditions to detariff embedded CPE.[9]

7. Following our *Computer II* decisions, Congress enacted the Telecommunications for the Disabled Act to assure that hearing impaired persons obtain reasonable access to telephone service. More specifically, section 610(g) was designed to assure that equipment needed by the disabled to use telephone service would be available at affordable prices. Section 610(g) provides:

> Any common carrier or connecting carrier may provide specialized terminal equipment needed by persons whose hearing, speech, vision, or mobility is impaired. The State commission may allow the carrier to recover in its tariffs for regulated service reasonable and prudent costs not charged directly to users of such equipment.

The Act does not address specifically whether this Commission can still order detariffing of specialized CPE or whether detariffing is left to the states; in fact, there is considerable ambiguity as to how the Congressional scheme is intended to work. We do know that the Act contemplates that state public utility commissions have the power to conduct programs whereby the costs of providing specialized CPE may be subsidized from revenues for regulated services. States may find that, in determining whether only reasonable and prudent costs of providing specialized CPE are included in revenue requirements, the tariffing of specialized CPE may be useful. On the other hand, a sales program, with or without subsidy, may be equally effective in meeting the needs of the hearing impaired in the future. Since we believe that the states themselves are in the best position to decide whether the tariff mechanism for providing CPE should play a part in any subsidy program they may adopt, we have decided to dismiss AT&T's proposal and leave decisions on this matter to the states.

8. As we recognized in the Notice in this proceeding, "in our view, the . . . Act contemplates that this Commission leave to carriers and state commissions the decision whether or not specialized equipment will be tariffed . . . ." Notice at para. 33. The legislative history of the Act confirms this view:

> In its *Computer II* decision, the Commission required that the provision by carriers of terminal equipment . . . "be separate and distinct from the provision of common carrier communications services and not offered on a tariffed basis." The detariffing of terminal equipment will cause competition to drive prices to

[8] 77 FCC 2d at 444–45 (paras. 154–156).

[9] 88 FCC 2d at 541 n.34; *see* 84 FCC 2d at 103 (para. 154).

> costs and will effectively prevent the State commissions from regulating the price and other terms under which the consumer obtains terminal equipment. The Committee believes that, as applied to disabled persons, such a policy could lead to substantial price increases and reductions in the access to the nationwide network which persons with disabilities currently enjoy.

H.R. Rep. No. 97–888, 97th Cong., 2d Sess., at 13 (1982) (footnotes omitted) ("House Report").

9. In Congress' judgment states have been successful in overseeing the needs of disabled persons and Congress intended that the states be able to "continue programs that subsidize the provision of specialized terminal equipment to persons with physical disabilities."[10] This language appears to contemplate that the states would have the discretion as to how specialized CPE is provided by carriers. Congress believed that the mandatory detariffing of specialized CPE could limit the states in conducting existing or future programs for the disabled. Therefore, we conclude that Congress believed it would better effectuate the Act to leave to the states the determination whether to tariff or detariff specialized CPE. We note that AT&T does not argue that this Commission may preempt state commissions from requiring the tariffing of specialized CPE. Indeed, AT&T acknowledges that states may take remedial regulatory action concerning specialized CPE should its price predictability plan not accomplish its purpose. AT&T Supplementary Comments at 2.

10. We conclude that leaving to the states the decision whether to detariff specialized CPE will best meet the purposes of the Act. Given this conclusion, we see no reason to pass judgment on AT&T's price predictability plan. We conclude that we should not allow our implementation of the Disabled Act to disrupt the current provision of specialized CPE. The approach which would be most consistent with the Act and less disruptive than AT&T's proposal would be to leave specialized CPE tariffed or untariffed, as the case may be in the various states, and let those states with existing tariff programs decide when and under what conditions to detariff specialized CPE, if at all.

11. We note, however, that the language of the Act is permissive, and the legislative history does not express a preference for whether specialized CPE should be eventually offered on a tariffed or detariffed basis. House Report at 14. Thus, AT&T correctly asserts that a carrier may initially choose whether or not to continue to offer equipment under tariff. Even though the initial decision whether to tariff rests with the carrier, a carrier's exercise of that discretion may depend on its filing a detariffing plan with the appropriate state regulatory agency and obtaining approval. In other words, the Act affords state commissions the opportunity to determine, in an orderly fashion, whether the provision of specialized CPE

[10] House Report at 2.

pursuant to proposals such as AT&T's price predictability plan, is an appropriate way in which to provide equipment needed by disabled persons. Nevertheless, state action and the submission to the states of a plan by AT&T should await our adoption of rules implementing the Act. As noted, the Commission will adopt regulations no later than January 3, 1984.

12. Our decision here does not preclude AT&T from seeking at the appropriate time the detariffing of specialized CPE from state commissions. Although the price predictability plan is based on nationwide projections, AT&T may present its plan to individual states. We note AT&T's argument in the *Implementation Proceeding* that if CPE for consumers (including disabled customers) remained tariffed following divestiture, AT&T would be required to form an embedded base organization, which would cause it to incur substantial costs. AT&T Supplementary Comments, filed in the *Implementation Proceeding*, at 13–14 (October 28, 1982). In order to avoid the complexities and costs AT&T may face in dealing with many state commissions, AT&T and the BOCs may wish to negotiate an arrangement leaving specialized CPE with the BOCs.[11] The BOCs have a greater presence in each state than AT&T, and have experience dealing with the procedures of the individual commissions.

IV. *ORDERING CLAUSES*

13. THEREFORE, the Motion for Expedited Consideration filed August 23, 1983, by National Center for Law and the Deaf, *et. al.*, IS GRANTED IN PART AND DENIED IN PART AS DESCRIBED HEREIN.

14. IT IS FURTHER ORDERED that the price predictability and sales plan filed September 15, 1983 by the American Telephone and Telegraph Company IS DISMISSED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

[11] A memorandum written by the Court in the *MFJ* proceedings indicates that "[t]he Court's approval of the decree's provisions regarding embedded CPE is . . . without prejudice to whatever equitable arrangements may be made among AT&T, the operating companies, and the representatives of the disabled regarding continued subsidization of [specialized] equipment." Memorandum from Judge Harold Greene at ¶ 6 (August 5, 1983).

Application For Review
Authority Delegated, Action on
Hearing, Designation For
Review By Commission

Application for review of Hearing Designation Order (Mimeo No. MM4297, released May 24, 1983) which waived Section 73.37(e)(1)(ii) of rules and accepted for filing competing applications for CPs granted. Mass Media Bureau exceeded it delegated authority by acting on a novel question of law, fact, and policy. –*Tully-Warwick Corp.*, MM Docket No. 83–505

FCC 83–560

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In re Applications of	
TULLY-WARWICK CORPORATION Concord, New Hampshire	MM Docket No. 83–505 File No. BP-810706AU
Req: 1140 kHz, 5 kW, DA-D	
CONCORD BROADCASTING ASSOCIATES Concord, New Hampshire	MM Docket No. 83–506 File No. BP-820628AH
Req: 1140 kHz, 10 kW, DA-D	
For Construction Permit	

MEMORANDUM OPINION AND ORDER

(Adopted: November 23, 1983; Released: November 30, 1983)

BY THE COMMISSION:

1. Now before the Commission is an Application for Review[1] filed by Capitol Broadcasting Corporation (Capitol) on June 30, 1983

[1] Pursuant to Section 1.115(e)(3) of our Rules, the presiding Administrative Law Judge certified Capitol's Application for Review to the Commission by Order released June 23, 1983, FCC 83M-2062.

and oppositions thereto filed July 13, 1983 by the Mass Media Bureau and by Tully-Warwick Corporation (TWC).[2] Capitol seeks review of that part of the Hearing Designation Order[3] in this proceeding, which waived Section 73.37(e)(1)(ii) of the Commission's Rules[4] and accepted for filing the competing applications of TWC and Concord Broadcasting Associates (CBA) for a new daytime only standard broadcast station at Concord, New Hampshire. For the reasons which follow, we will grant Capitol's Application for Review.

Background

2. TWC originally filed an application for a new daytime only AM station for Concord on July 13, 1979. That application specified 1320 kHz as the frequency requested. Since TWC's application was mutually exclusive with that of Spacetown Communications Corporation (Spacetown), which was seeking a daytime only AM station on the same frequency for Derry, New Hampshire, both applications were designated for consolidated hearing in docketed proceedings BC 81–151 and 152.[5] At that time, both applicants were in compliance with Section 73.37(e)(1)(ii), inasmuch as TWC proposed a second aural transmission service[6] and Spacetown proposed a first aural transmission service for their respective communities where no FM channels were available. Prior to evidentiary hearings in those proceedings, the parties entered into an agreement which would remove the electrical conflict between their proposals. Essentially, the agreement provided that Spacetown would reimburse TWC for a portion of its expenses in prosecuting its application and that TWC would amend its application to specify 1140 kHz instead of 1320 kHz. TWC also agreed that it would request the dismissal of its application in the event the Commission ultimately rejected the amend-

[2] Capitol Broadcasting Corporation is the licensee of WKXL(AM) and WKXL-FM, Concord, New Hampshire and has standing in this proceeding as an economic competitor. *See FCC* v. *Sanders Brothers Radio Station*, 309 U.S. 470 (1940).

[3] Mimeo No. MM 4297, released May 24, 1983

[4] Rule 73.37(e)(1)(ii) requires an applicant for a new daytime only standard broadcast station to demonstrate: "That the proposed station would provide the community designated in the application with a first or second authorized aural transmission service, and that no FM channel is available for use in that community."

[5] Hearing Designation Order, released March 12, 1981, 46 Fed.Reg. 12258.

[6] Although Capitol is the licensee of Station WKXL and WKYL-FM, Note 7 to Rule 73.37 provides that: "Where an AM broadcast station and an FM broadcast station authorized to the same community are commonly owned, these stations shall be considered as providing a single aural transmission service to that community for the purpose of determining the acceptability of applications pursuant to paragraphs (e)(1)(ii) and (e)(2)(ii) of the section."

ment. Thereafter, the parties requested approval of their agreement by the Administrative Law Judge (ALJ) in those proceedings.[7] TWC also filed with the ALJ a Motion for Leave to Amend and an amendment to its application, specifying the new frequency. The ALJ accepted TWC's amendment and, in accordance with its Motion for Leave to Amend, severed the amended TWC application from the docketed proceedings and returned it to the processing line where it was given a new file number.[8] Spacetown's application was thereafter granted and the ALJ terminated those docketed proceedings.[9]

3. After TWC's amended application was returned to the processing line, Capitol filed a timely challenge to that application. Capitol asserted, *inter alia*, that the application was no longer acceptable for filing under Section 73.37(e)(1)(ii). Since Concord already had an existing station and since FM Channel 288A was assigned to that community on November 17, 1980, TWC's proposal would exceed the prescribed ceiling of two aural services permitted by the Rule. TWC opposed Capitol's petition, after being granted numerous requests for extensions of time totalling nearly six months. The Chief of the Broadcast Facilities Division of the Broadcast Bureau[10] thereafter notified Capitol that the circumstances surrounding TWC's major amendment of its earlier filed application presented a "colorable claim of acceptability" under Section 73.37(e)(1)(ii) and that to prevent further processing delays the application would be accepted and a cut-off date would be announced for the filing of competing applications.[11] CBA, the other applicant in this proceeding, then filed its competing application. Again, Capitol timely challenged TWC's application as unacceptable by filing a Motion to Delete Application from Cut-off List. It also timely petitioned to dismiss or deny the CBA application for the same reason.

4. On May 11, 1983, the Chief of the Mass Media Bureau, acting pursuant to delegated authority, designated TWC's and CBA's applications for consolidated hearing in this proceeding. In doing so, the Bureau rejected Capitol's contentions that both applications are unacceptable for filing under Section 73.37(e)(1)(ii) and should be dismissed, as alleged by that petitioner in its earlier filed petitions. Although the Bureau concluded that TWC's amended application did not technically conform with Section 73.37(e)(1)(ii), it nevertheless found that the application did comport with the intent of the Rule as well as with Note 6 to the Rules.[12] The Bureau further reasoned that

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[7] Rejected in part by the ALJ, FCC 81M-2633, released August 24, 1981, but ultimately approved, as proposed, by the Review Board, FCC 81R-100, released October 26, 1981.

[8] FCC 81M-2182, released July 16, 1981.

[9] FCC 81D-40, released September 1, 1981.

[10] Now the Mass Media Bureau.

[11] Letter from Chief, Broadcast Facilities Division to Capital Broadcasting Corp. Inc., dated May 26, 1982, reference number 8910-JMS.

the ALJ would not have accepted TWC's amendment and returned the application to the processing line if the effect would have been dismissal. Moreover, the Bureau concluded that dismissal of the application would effectively abrograte the ALJ's determination in the Spacetown/TWC proceeding that acceptance of the amendment would moot a Section 307(b) issue and would also likely result in both Concord and Derry receiving a new daytime AM facility. In light of these unique circumstances, the Bureau held that a grant of TWC's request for waiver of the Rule would serve the public interest. With regard to the CBA application, the Bureau likewise found that it did not technically conform to Section 73.37(e)(1)(ii). Noting that the applicant did not request a waiver or demonstrate how its application was otherwise acceptable for filing, the Bureau nevertheless concluded that the Commission's policy favoring a choice of applicants at hearing outweighed any potential detriment that may be caused by waiver of the Rule. Accordingly, on its own motion, the Bureau waived Section 73.37(e)(1)(ii) and accepted the CBA application.

Discussion

5. We agree with Capitol that the Bureau exceeded its delegated authority in taking the action here challenged. Section 0.281(a)(18)(ii) of Commission's Rules, governing the Bureau's delegated authority powers, makes clear that the full Commission must act on novel questions of law, fact and policy which cannot be resolved under existing guidelines and precedents. As the ALJ aptly pointed out in certifying this matter to us, there is no Commission precedent—one way or the other—on the appropriateness of waiver of Section 73.37(e)(1)(ii) under circumstances similar to those presented in this case.[13] Hence, a novel question of law, fact and policy was and is presented which warrants consideration by the full Commission. Accordingly, the Bureau's Hearing Designation Order in this proceeding will be vacated. For these same reasons, we find that Capitol has made the prerequisite showing warranting a grant of its Application for Review.

6. We now turn to the core questions in this proceeding: (1) whether the respective applications comport with the requirements of Section 73.37(e)(1)(ii); and (2) if not, whether circumstances have been presented which would justify waiving that Rule. For the reasons which follow, we resolve these questions adversely to the applicants.

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[12] For the reasons set forth in paragraph 8, *infra*, we find no basis for either of the Bureau's holdings. Note 6 provides, *inter alia*, that an FM channel is not available for use if, at the time an application for a new standard broadcast station is tendered, "no channel is assigned to the community for commercial use in the FM Table of Assignments. . . ."

[13] FCC 83M-2062, released June 23, 1983.

7. Section 73.37(e)(1)(ii) is an essential element in the Commission's allocation scheme for assigning AM broadcast channels. As mentioned, that Section requires an applicant for a new daytime only AM station to demonstrate that the proposed station will provide the designated community with a first or second authorized aural transmission service, and that no FM channel is available for use in the designated community. Its dual purpose is to reserve scarce AM channels for communities where there is no aural transmission service and to promote FM service in communities where improvements in the existing level of aural transmission services are clearly needed.[14]

8. There is no question that when TWC filed its original application it met the criteria of Section 73.37(e)(1)(ii): its proposal would have constituted a second aural transmission service in a community where no FM channels were available. However, prior to effectuating the major change to its application, a new FM channel (288A) was assigned to Concord by the Commission on November 17, 1980. Thus, when TWC amended its application and the ALJ returned it to the processing line, it no longer met the criteria of the Rule inasmuch as a FM channel was then available for Concord. Moreover, we find no merit to TWC's contention that its amended application was nevertheless acceptable by virtue of Note 6 to Section 73.37. The sole purpose of that Note is to provide a time certain—the application's tender date—in which to determine whether an FM channel is available to a particular community. To hold, as TWC suggests, that an applicant, who has effectuated a major change in its application constituting an entirely new proposal, may nevertheless rely on the tender date of its original application as the benchmark for compliance with the criteria of Section 73.37(e)(1)(ii) would not only frustrate the allocation objectives sought to be served by the Rule, but would be inconsistent with longstanding Commission processing procedures governing major amendments to applications.[15] Having concluded that Note 6 provides no basis for holding that TWC's amended application complies with Section 73.37(e)(1)(ii), it follows that Note 8 to that Rule is equally unavailing to TWC.[16] TWC clearly lost its protected status to

[14] *Broadcast Station Assignment Standards*, 39 FCC 2d 645 (1973).

[15] *See*, for instance, Section 73.3571 (governing the processing of major amendments) and Section 73.3580 (requiring the republishing of local public notice for major amended applications).

[16] Note 8 provides:

> In determining the number of "authorized" aural transmission facilities in a given community, applications for that community in hearing or otherwise having protected status under specified "cut-off" procedures shall be considered as existing stations. In the event that there are two or more mutually exclusive protected applications seeking authorization for the proposed community it will be assumed that only one is "authorized."

be considered an existing station for the purposes of that Note when it effectuated a major amendment to its application and requested the ALJ to sever the application from the earlier TWC/Spacetown proceedings and return it to the processing line.

9. We now turn to whether circumstances have been presented which would persuade us to waive Section 73.37(e)(1)(ii). As often stated, to justify a waiver an applicant must overcome a high hurdle: in addition to showing that the public interest will be served by an exception to the Rule, an applicant must also demonstrate that the public policy objectives sought to be served by the Rule are not undermined.[17] In our opinion, TWC has failed in both respects.

10. To begin with, we find no reason to predicate waiver on the basis of Section 307(b) of the Act.[18] That Section, among other things, mandates the fair, efficient and equitable distribution of radio services among the various communities. Inherent in the provisions of Rule 73.37 are the broad concerns of Section 307(b). The Commission has long recognized this in refusing to rely on Section 307(b) as a basis for waiving its basic allocation standards.[19] It has stated that the Rule already "encompasses all of the public interest factors favoring one demand for spectrum space over another,"[20] and is "designed to insure in the AM band the 'fair, efficient and equitable distribution of radio service' mandated by Section 307(b) . . ."[21] In those rare instances where the Commission has considered waiving this allocation rule, its considerations have been based upon a threshold assertion that some overriding public interest policy, such as promotion of minority ownership[22] or need for foreign language programming,[23] would be furthered by grant of the waiver. We perceive no such policy considerations here and, as heretofore stated, conclude that waiver of Rule 73.37(e)(1)(ii) on the basis of Section 307(b) of the Act would be inappropriate. This latter conclusion is amply illustrated by the facts here presented. As hereafter mentioned, the Commission assigned a new FM channel to Concord and, hence, that community's 307(b) needs have been accommodated by virtue of other provisions of the Commission's basic allocation scheme.

11. Nor do we find the equities suggested by TWC a sufficient basis for waiver. We can discern no evidence in the earlier TWC/Spacetown proceedings indicating that the ALJ was motivated to approve the settlement agreement because it would likely result

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[17] *WAIT Radio, Inc.* v. *FCC*, 406 F.2d 664 (D.C. Cir. 1968).

[18] Communications Act of 1934, as amended, 47 U.S.C. § 307(b).

[19] *Cf. WCSV, Inc.*, 46 FCC 2d 159, 160–161 (1974).

[20] *ICBC Corporation*, 89 FCC 2d 447, 449 (1982).

[21] *Bunkfeldt Broadcasting Corp.*, 88 FCC 2d 1696, 1697 (1982).

[22] *See e.g., Por Favor, Inc.*, 68 FCC 2d 73 (1978); and *see also Clear Channel Broadcasting in the AM Broadcast Band*, 78 FCC 2d 1345 (1980).

[23] *See Riverside Amusement Park Co., Inc.*, 69 FCC 2d 1040 at 1043 (1978).

in both Concord and Derry receiving new daytime AM facilities. The ALJ's attention in considering and approving the settlement was narrowly focused on the question of whether the settlement would accomplish the purpose of providing a first aural service to Derry, New Hampshire. Moreover, the suggestion that TWC entered into the settlement agreement only because it believed it would be permitted to apply for a second aural service for Concord is belied by the terms of the settlement agreement, which specifically provided for dismissal of the TWC application in the event the Commission ultimately disallowed the amendment of its application.[24] And, as Capitol aptly points out, TWC had ample reason to expect that its application might be deemed unacceptable since some eight months prior to the parties consummating their settlement agreement, a new FM channel had been assigned to Concord, and public notices of that assignment and the two competing applicants who had applied for the FM channel were given.[25] In our opinion, this further militates against any suggestion that the ALJ was motivated to approve the agreement because it would also likely result in Concord receiving a second aural service or that any equities arise in TWC's favor.[26]

12. CBA's application, like TWC's, does not comply with Section 73.37(e)(1)(ii), inasmuch as it too contemplates an additional aural service for Concord in excess of the prescribed ceiling of two aural services permitted by the Rule. As mentioned, CBA has not requested a waiver of the Rule, nor has it demonstrated how its application would otherwise be acceptable for filing. Under these circumstances, we will dismiss CBA's application. As with any applicant who tenders a nonconforming application that is not accompanied with an appropriate request for waiver, CBA assumed the risk that its application would not be acceptable for filing.[27] Moreover, as the courts have long recognized, the Commission may adopt substantive rules and policies which applications must satisfy, and an application that fails to comport with those rules and policies,

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[24] At page 2 of the "Settlement Agreement between Spacetown and Tully-Warwick Corporation," filed in Docket Nos. 81–151 and 81–152, July 2 and 6, 1981, TWC represented:

> In the event the FCC issues a final order denying the motion [for leave to amend] and disallowing the amendment, which order is no longer subject to administrative or judicial review, Tully-Warwick will tender a Motion to Dismiss its application pursuant to the provisions of Section 73.3568(c) of the Rules.

[25] Rumford Communications, Inc. was subsequently granted a license (83-0922AI) by the Commission for its new FM station WJYY(FM) at Concord on September 22, 1983.

[26] *Cf. Kansas State Network, Inc.* v. *FCC*, D.C. Cir., Case No. 82–1319, decided October 25, 1983, Slip Op. at p.5.

[27] *Cf. Ranger* v. *FCC*, 294 F.2d 240 (D.C. Cir. 1961).

unless accompanied by an appropriate request for waiver, can be returned without consideration or dismissed.[28]

13. ACCORDINGLY, IT IS ORDERED, That the Application for Review filed June 30, 1983 by Capitol Broadcasting Corporation IS GRANTED.

14. IT IS FURTHER ORDERD, That the Hearing Designation Order, MM 4297, released May 24, 1983 in this proceeding IS VACATED.

15. IT IS FURTHER ORDERED, That the above-captioned applications (BP-810706AU and BP-820628AH) of Tully-Warwick Corporation and Concord Broadcasting Associates ARE DISMISSED.

16. IT IS FURTHER ORDERED, That this proceeding IS TERMINATED.

FEDERAL COMMUNICATIONS COMMISSION
WILLIAM J. TRICARICO, *Secretary*

[28] *United States* v. *Storer Broadcasting Co.*, 51 U.S. 192 (1956). *See also*, Section 73.3566 of the Commission's Rules governing defective applications.

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